

No. 11804

United States
Circuit Court of Appeals
For the Ninth Circuit.

KENNEDY NAME PLATE COMPANY, a Corporation,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

Transcript of the Record

Upon Petition to Review Decision of the Tax Court
of the United States

FILED

JAN 28 1948

PAUL P. O'BRIEN, /

CLERK

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[Clerk's Note: When deemed likely to be of an important nature, errors or doubtful matters appearing in the original certified record are printed literally in italic; and, likewise, cancelled matter appearing in the original certified record is printed and cancelled herein accordingly. When possible, an omission from the text is indicated by printing in italic the two words between which the omission seems to occur.]

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APPEARANCES

C. EARLE MEMORY,

PRESTON D. OREN,

For Taxpayer.

E. A. TONJES,

For Commissioner.

The Tax Court of the United States
Docket No. 6695

KENNEDY NAMEPLATE COMPANY,
A Corporation,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

DOCKET ENTRIES

1944

Dec. 11—Petition received and filed. Taxpayer notified. Fee paid.

Dec. 11—Copy of petition served on General Counsel.

Dec. 27—Entry of appearance of C. Earle Memory as counsel filed.

1945

Feb. 5—Answer filed by General Counsel.

Feb. 5—Request for hearing in Los Angeles, California filed by General Counsel.

Feb. 9—Notice issued placing proceeding on Los Angeles calendar. Service of answer and request made.

1946

Apr. 16—Hearing set June 10, 1946, Los Angeles, Calif.

1946

- June 12—Hearing had before Judge Black on merits. Appearance of Preston D. Oren, as counsel filed at hearing. Petitioner's brief due 8/1/46. Respondent's brief due 9/1/46. Petitioner's reply due 10/1/46.
- July 1—Transcript of hearing 6/12/46 filed.
- July 29—Brief filed by taxpayer. Copy served.
- Sept. 5—Motion for extension to Oct. 1, 1946, to file respondent's brief filed by General Counsel. 9/6/46. Granted.
- Sept. 27—Reply brief filed by General Counsel. Served 9/30/46.
- Oct. 15—Reply brief filed by taxpayer. Copy served.

1947

- May 29—Memorandum findings of fact and opinion rendered, Judge Black. Decision will be entered under Rule 50. 6/3/47 copy served.
- June 20—Motion to vacate and set aside the Memorandum findings of fact and opinion filed by taxpayer.
- July 9—Respondent's computation for entry of decision filed.
- July 14—Hearing set August 6, 1947, Wash., D. C., on Rule 50.
- July 14—Order denying motion to vacate and set aside memorandum findings of fact and opinion entered.

1947

July 29—Consent to respondent's computation filed.

July 30—Decision entered, Judge Black, Div. 15.

Oct. 27—Petition for review by U. S. Circuit Court of Appeals, Second Circuit, with assignments of error filed by taxpayer.

Nov. 3—Proof of service filed.

Nov. 10—Designation of record filed by taxpayer.

Nov. 24—Proof of service of designation of record filed. [1*]

The Tax Court of the United States

Docket No. 6695

KENNEDY NAMEPLATE COMPANY, a Corporation,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

PETITION

The above-named petitioner hereby petitions for a redetermination of the deficiency set forth by the Commissioner of Internal Revenue in his notice of deficiency (LA:IT:90D:PAK) dated September

* Page numbering appearing at top of page of original certified Transcript.

21, 1944, and as a basis of his proceeding alleges as follows:

1. The petitioner is a corporation incorporated under the laws of the State of California with principal office at 4509 Pacific Boulevard, Los Angeles, 11, California. The returns for the periods here involved were filed with the Collector for the 6th District of California.

2. The notice of deficiency (copy of which is attached and marked Exhibit "A") was mailed to the petitioner on September 21, 1944.

3. The taxes in controversy are income, excess profits, declared value excess profits and Section 102 taxes for the fiscal years ended June 30, 1941, and June 30, 1942, and in the amount of \$30,098.59.

4. The determination of tax set forth in the said notice of deficiency is based upon the following errors:

(A) The commissioner proposes to disallow the compensation paid to J. W. Hayek and W. J. Kennedy in the amount of \$5,936.58 each for the fiscal year ended June 30, 1941, and \$5,858.18 each for the fiscal year ended June 30, 1942.

(B) The commissioner contends that for each of the taxable years ended June 30, 1941, and June 30, 1942, the petitioner was availed of for the purpose of preventing the imposition of surtax upon its shareholders through the medium of permitting its earnings to accumulate beyond the reasonable needs of its business

and has accordingly imposed a surtax under the provisions of Section 102 of the Internal Revenue Code in the amounts of \$6,544.38 and \$9,115.11 for each of such years respectively.

5. The facts upon which the petitioner relies as the basis of this proceeding are as follows:

Compensation of Officers

The Commissioner has not alleged that the services were not rendered and this petitioner is therefore submitting no facts on that point. [2]

Mr. J. W. Hayek is the president of the corporation and all of his time is devoted to the supervision of the petitioner's production and technical activities. Mr. W. J. Kennedy is the Secretary-Treasurer of the corporation and is in complete charge of the administrative, executive, sales and engineering activities of the petitioner. These two men are solely responsible for all of the activities of the corporation since its inception 23 years ago and have devoted all of their time to its business.

Mr. Hayek has spent the past 35 years in the technical aspect of the production of nameplates and allied products, is a recognized authority in this field and was one of the pioneer nameplate manufacturers in the United States. His technical skills comprise etching, chemical and electro plating, finishing of metals, sheet metal working, tool and die making, photographic techniques, decalcomania, plastics and their derivatives, properties and uses of acids, lithography, production and manu-

facturing techniques. He has been a leader in these fields from the beginning of the industry.

Mr. Kennedy has been a sales and administrative executive for more than 30 years and has held executive positions with such firms as Stewart Manufacturing Company of Chicago, International Products Company of New York, Cia International de Productos and Cia Central de Productos of Argentine and Paraguay, Marshall Field & Company of Chicago and (more than 25 years ago) was assistant to the Vice-President of Sulzberger & Sons (later Wilson & Company, packers). His educational background includes seven years post graduate work in advertising and sales engineering at the University of Southern California, two years as director of University College and the recent completion of a course in plastic chemistry conducted by the California Institute of Technology and is a recognized plastic engineer.

Mr. Kennedy purchased the Hayek Nameplate Company in Minneapolis in 1921 and immediately moved it to California and incorporated it in 1923 as the Kennedy Nameplate Company, the petitioner herein. Mr. Hayek came with the company and these two men have operated the company jointly since that time.

In the latter part of 1943 the National Engraving Company of Racine, Wisconsin, made an offer to purchase a 51% interest in the business of the petitioner and to retain Mr. Hayek and Mr. Kennedy to continue to run said business at the rate of compensation being then paid them by the peti-

tioner which was \$17,418.24 per annum each. This offer was rejected by them. They were not willing to work for anyone else for what they considered to be the modest compensation paid to them by the petitioner. When Mr. Kennedy was 37 years of age (25 years ago) he refused a business opportunity offered him in South America that would have guaranteed him earnings of \$25,000 per year.

With reference to A.R.R. 53, 2CB110 the following matters are pertinent. The annual compensation of each of the officers has never been in excess of \$18,000 and there has been no allocation of any intent to reduce the taxes of the corporation thereby. It has been the established policy of the petitioner for the past 13 years to pay bonuses to all of its permanent personnel. The remaining net profits of the petitioner for the subject years were approximately \$47,000 and \$92,000 respectively, these amounts being returns of 48½% and 66% of its invested capital respectively and it paid substantial income and excess profits taxes for the subject years of approximately \$67,000. The petitioner contends that the compensation paid to its officers does not reduce the net earnings subject to tax below that of competing concerns that secured the services of officers and employees by open bargaining. Under the management of these two men, the net sales of the petitioner increased from \$98,354 to \$256,451 and the number of employees [3] increased from 39 to 73 during the five-year period ended June 30, 1941. Subsequent substantial increases in produc-

tion have been brought about by the war-production program.

The petitioner alleges that the salaries paid to its executive officers set forth in the following schedule were not excessive and were not in excess of those that said officers could have reasonably expected to have obtained elsewhere and that the petitioner received full value for such compensation and that the full amounts of said compensation were reasonable and necessary to the conduct of the petitioner's business:

Name	1941	1942
Joseph W. Hayek.....	\$17,936.58	\$17,858.18
William J. Kennedy.....	\$17,936.58	\$17,858.18

Undistributed Net Income June 30, 1941

The net income for the taxable year ended that day was \$46,942.07, the federal taxes on income paid thereon were \$16,709.61, leaving undistributed income of \$30,232.46. This remaining income was not distributed for the reason that at that time the petitioner had under way a program of expansion that had been in process for several years and was essential to its continued existence. The plan actually in process on that date entailed a minimum expenditure of \$217,500 and a maximum of \$252,500. This was to be financed from its \$50,000 working capital, the sale of its existing plant for about \$60,000, by funds provided by shareholders of \$50,000 and the balance was to be taken care of by a trust deed on the new plant. When the United

States entered the war subsequent to this date necessary curtailment of materials required that this plan be held in abeyance and it is still the intention of the petitioner to consummate this plan as soon as construction materials and manufacturing equipment are available. This is the only way the petitioner can successfully continue in the nameplate business.

Following are some specific instances proving why petitioner needed all available funds for expansion necessary to its continued existence:

(A) In December 1940 the petitioner purchased an industrial site with trackage at 5511 Boyle Avenue, Los Angeles. It designed for erection thereon an efficient manufacturing facility as its existing plant had grown to the point where it was inefficiently operated and did not have space for needed equipment and processes. This plant was to cost approximately \$100,000.

(B) The petitioner's principal lithographing press was purchased second-hand in 1931 and was worn out and obsolete. In the latter part of 1940 and the early part of 1941 it was negotiating for the purchase of a new press to be installed at a cost of between \$50,000 and \$75,000. During such negotiations it communicated with R. J. Hoe Company, manufacturers, and Fuchs and Lang. The petitioner's president, Mr. Hayek, went east on this matter in 1941 and spent 13 weeks visiting other nameplate manufacturers and press manufacturers for the purpose of determining what type of press was most suited for the petitioner's needs. This

press was to be installed in the new plant as the existing plant was not large enough to accommodate it.

(C) On June 30, 1941, the petitioner was engaged in designing a complete infra-red conveyor system and continuous finishing equipment that would have materially reduced its manufacturing costs. This was also to be installed in its new plant and would entail an expenditure of between \$15,000 and \$25,000.

(D) At this time the petitioner was negotiating with the Aluminum Corporation of America for their anodyzing and alumilizing process that would have required considerably more floor space than was available in the petitioner's existing plant. This would have entailed an expenditure of \$5,000 for the necessary equipment and \$5,000 fee for a manufacturing license.

(E) The petitioner's cost of moving to its new plant was estimated at \$7,500 and it was expecting to spend an additional \$35,000 for heavy equipment necessary to the more economical and efficient manufacture of its products.

Undistributed Net Income June 30, 1942

The net income for the taxable year ended that day was \$91,747.72, the federal taxes on income paid thereon were \$49,985.96, leaving undistributed income of \$41,761.76. This remaining income was not distributed for two reasons, (1) the petitioner required part of this working capital for the hereinbefore described expansion of manufacturing facilities and, (2) the petitioner required the remainder

of its working capital for the extensive reconversion to peacetime production of its facilities that had been converted to war production in the interim. The following examples will illustrate this need:

(A) On that date all of the petitioner's facilities were engaged in production for the war effort, many of its existing facilities had been rendered useless for peacetime production and considerable capital would be needed to restore them.

(B) The petitioner was required to provide substantial reserves, not recognized by income tax purposes for inventory losses. As an example, aluminum was then 26c a pound and is expected to approximate 10c per pound after the war.

(C) The petitioner was required to maintain funds to cover inevitable losses on contract terminations as the type of its manufacturing activities are not such that all losses could be recovered under termination procedures.

(B) The petitioner believes that it will be necessary to maintain an uneconomical number of employees during the reconversion period in order to hold its organization intact.

(E) Upon reconversion, the petitioner will be required to spend approximately \$25,000 to restore its plating equipment, which had been abandoned during war production, and which will again be needed for peacetime production.

(F) The plastics engraving equipment, costing \$18,000 will be obsolete upon the cessation of war production, a loss not recognized during this period.

(G) Good business practice requires that the

petitioner maintain sufficient funds to act as a cushion against expected operating losses during the reconversion period and in the immediate post-war period.

(H) Funds will also be required to build a new distributing organization and to find altogether new outlets for selling its products during the post-war period.

(I) War-time technological advances have so reduced the costs of making nameplates that there will not be sufficient dollar volume in the post-war period to insure the petitioner's continued existence in that field alone, and it will therefore be necessary for the petitioner to enter other fields rather than to try to exist on nameplate manufacturing alone.

(J) The petitioner has been making considerable research into the use of [5] plastics and it is expected that they will replace some materials after the war. This will require new machinery and equipment to handle new metals, plastics and combinations of the two.

In summary, the petitioner alleges that for the year ended June 30, 1942, it had abandoned its peacetime activities and converted its entire facilities to war production and it is therefore entitled to accumulate reserves from such business to pay for not only the costs and losses of getting out of war production but the development of such new products as the developments of war production have shown will be necessary to insure its continued existence after the war. The petitioner also alleges

that it had to chop up its manufacturing plant and tear out certain of its built-in equipment to meet immediate needs of the aircraft industry, all of which must be restored. It will be impossible for it to compete in the post-war period at its present location unless it spends as much money to restore its plant to its original condition as the new plant and equipment contemplated in its original expansion program as at June 30, 1941, would cost.

The petitioner alleges that it, as a manufacturing corporation, was not availed of for the purpose of preventing the imposition of taxes upon its shareholders through the medium of permitting its earnings to accumulate beyond its reasonable needs.

With respect to the year ended June 30, 1941, the laws and regulations necessary to the successful prosecution of the war made it impossible for the petitioner to consummate its definite expansion program actually under way on that date and it should not be prohibited from accumulating funds for such purpose to be used when such controls are released.

With respect to the year ended June 30, 1942, with the exigencies of war production and the inevitable losses contingent upon the cessation thereof and the restoration of its plant, the petitioner alleges that it accumulated no more funds than were necessary to the successful prosecution of its business and reconversion of it.

The petitioner has not invested any of its funds. None of its funds were loaned to stockholders, in fact all during the first year under review it owed its stockholders \$16,997.54 which it paid during the

next year. The petitioner alleges that for both of these years it has not accumulated any funds beyond its reasonable current and foreseeable needs. [6]

Wherefore, the petitioner prays that this Court may hear the proceeding and find that no additional income and/or excess profits taxes and/or declared value excess profits taxes are due from the petitioner for the taxable years ended June 30, 1941, and June 30, 1942.

/s/ WILLIAM J. KENNEDY,
Secretary-Treasurer for the
Petitioner.

State of California,
County of Los Angeles—ss.

William J. Kennedy, being duly sworn, says that he is the Secretary-Treasurer of the Kennedy Nameplate Company, a corporation, the above-named petitioner; that he is duly authorized to verify the foregoing petition; that he has read same and is familiar with the statements contained herein, and that the statements contained therein are true, except those stated to be upon information and belief and that those he believes to be true.

/s/ WILLIAM J. KENNEDY.

Subscribed and sworn to before me this 5th day of December, 1944.

[Seal] /s/ GERTRUDE OSTLING,
Notary Public in and for the County of Los Angeles,
State of California.

My Commission Expires March 5, 1947. [7]

EXHIBIT "A"

[Letterhead Treasury Department]

Office of Internal Revenue Agent in Charge Los
Angeles Division. LA-IT:90D:PAK.

Sept. 21, 1944

Kennedy Name Plate Co.
4509 Pacific Boulevard
Los Angeles 11, California

Gentlemen:

You are advised that the determination of your income tax liability for the taxable years ended June 30, 1941 and 1942, discloses a deficiency of \$19,800.59; that the determination of your declared value excess-profits tax liability for the taxable years ended June 30, 1941 and 1942, discloses a deficiency of \$3,113.83; and that the determination of your excess profits tax liability for the taxable years ended June 30, 1941 and 1942, discloses a deficiency of \$7,184.17, as shown in the statement attached.

In accordance with the provisions of existing internal revenue laws, notice is hereby given of the deficiency or deficiencies mentioned.

Within 90 days (not counting Sunday or a legal holiday in the District of Columbia as the 90th day) from the date of the mailing of this letter, you may file a petition with The Tax Court of the United States, at its principal address, Wash-

ington, D. C., for a redetermination of the deficiency or deficiencies.

Should you not desire to file a petition, you are requested to execute the enclosed form and forward it to the Internal Revenue Agent in Charge, Los Angeles, California, for the attention of LA:Conf. The signing and filing of this form will expedite the closing of your return(s) by permitting an early assessment of the deficiency or deficiencies, and will prevent the accumulation of interest, since the interest period terminates 30 days after filing the form, or on the date assessment is made, whichever is earlier.

Very truly yours,

JOSEPH D. NUNAN, JR.,

Commissioner.

By /s/ GEORGE D. MARTIN,

Internal Revenue Agent in
Charge.

PAK:vme

Enclosures:

Statement

Form of Waiver

STATEMENT

LA:IT:90D:PAK

Kennedy Name Plate Co.

4509 Pacific Boulevard

Los Angeles 11, California [8]

TAX LIABILITY FOR THE TAXABLE YEARS
ENDED JUNE 30, 1941 AND JUNE 30, 1942

Income Tax			
Year	Liability	Assessed	Deficiency
June 30, 1941.....	\$19,988.72	\$10,970.93	\$ 9,017.79
June 30, 1942.....	28,908.28	18,125.48	10,782.80
Total	\$48,897.00	\$29,096.41	\$19,800.59

Declared Value Excess-Profits Tax			
June 30, 1941.....	\$ 2,797.14	\$ 1,229.87	\$ 1,567.27
June 30, 1942.....	7,042.41	5,495.85	1,546.56
Total	\$ 9,839.55	\$ 6,725.72	\$ 3,113.83

Excess Profits Tax			
June 30, 1942.....	\$ 6,902.82	\$ 4,508.81	\$ 2,394.01
June 30, 1942.....	31,766.30	26,976.14	4,790.16
Total	\$38,669.12	\$31,484.95	\$ 7,184.17

In making this determination of your tax liability, careful consideration has been given to the report of examination dated August 6, 1943 to your protest dated September 24, 1943 and to the statements made at the conferences held on October 19, 1943, March 21, 1944, July 6, 1944 and August 4, 1944.

It is held that the sums paid to your officers as alleged compensation, and deducted from gross income in computing your taxable net income, for the taxable years ended June 30, 1941 and 1942 exceed reasonable allowances for services rendered in such years within the purview of section 23 of the Internal Revenue Code to the following extent:

Taxable Year Ended June 30, 1941

Item of Alleged

	J. W. Hayek	W. J. Kennedy
Compensation		
Bonus	\$5,000.00	\$5,000.00
Proceeds from sale of scrap material retained by officer..	936.58	936.58
Amounts deemed excessive.....	<u>\$5,936.58</u>	<u>\$5,936.58</u>

Taxable Year Ended June 30, 1942

Bonus	\$5,000.00	\$5,000.00
Proceeds from sale of scrap material retained by officer..	858.18	858.18
Amounts deemed excessive.....	<u>\$5,858.18</u>	<u>\$5,858.18</u>

It is held that for each of the taxable years ended June 30, 1941 and 1942, you were availed of for the purpose of preventing the imposition of surtax upon your shareholders through the medium of permitting your earnings and/or profits to accumulate beyond the reasonable needs of your business instead of being divided or distributed. Accordingly, surtax is imposed upon you for each of said taxable years ended June 30, 1941 and June 30, 1942 under the provisions of section 102 of the Internal Revenue Code.

A copy of this letter and statement has been mailed to your representative, Mr. C. Earle Memory, Commercial Exchange Building, Los Angeles 14, California, in accordance with the authority contained in the power of attorney executed by you.

ADJUSTMENTS TO NET INCOME

Taxable Year Ended June 30, 1941

Net Income as disclosed by return.....		\$46,942.07
Forwarded		46,942.07
Unallowable Deduction and Additional Income:		
(a) Compensation of Officers....	\$10,000.00	
(b) Proceeds from Sale of Scrap Omitted from Income Re- ported	1,873.16	11,873.16
Net Income Adjusted.....		<u>\$58,815.23</u>

Explanation of Adjustments

These Adjustments Have Been Previously Explained
Computation of Declared Value Excess-Profits Tax

Taxable Year Ended June 30, 1941

Net Income Adjusted.....	\$58,815.23
Less: 10% of \$300,999.00, Value of Capital Stock as Declared in the Capital Stock Tax Return for the Year Ended June 30, 1941....	30,099.90
Net Income Subject to Declared Value Excess-Profits Tax	\$28,715.33
Amount Taxable at 6% (5% of \$300,999.00)	15,049.95
Amount Taxable at 12%.....	\$13,665.38
Declared Value Excess-Profits Tax:	
6% of \$15,049.95.....	\$ 903.00
12% of \$13,665.38.....	1,639.85
Total	\$ 2,542.85
Defense Tax (10% of \$2,542.85).....	254.29
Correct Declared Value Excess-Profits Tax Liability	\$ 2,797.14
Declared Value Excess Profits Tax Assessed:	
Original, Account No. October 420010	1,229.87
Deficiency of Declared Value Excess Profits Tax	\$ 1,567.27

Computation of Income Tax

Taxable Year Ended June 30, 1941

Tax Under Sections 13 and 15, Internal Revenue Code

Net Income \$58,815.23

Less: Declared Value Excess-
Profits Tax 2,797.14

Normal-Tax Net Income \$56,018.99

Income Tax:

22.1% of \$56,018.09..... \$12,380.00

Defense Tax:

1.9% of \$56,018.09..... 1,064.34

Total Income Tax Under Sections 13 and 15 \$13,444.34

Tax Under Sections 102 and 15, Internal Revenue Code

Net Income \$58,815.23

Less: Declared Value Excess-
Profits Tax \$ 2,797.14

Income Tax Under Sections 13 and 15..... 13,444.34

Excess Profits Tax (See
Below) 6,902.82 23,144.30

Section 102 Net Income..... \$35,670.93

Less: Basic Surtax Credit..... 11,873.16

Undistributed Section 102 Net
Income \$23,797.77

Income Tax:

25% of \$23,797.77..... \$ 5,949.44

Defense Tax (10% of
\$5,949.44) 594.94

Total Income Tax Under Sections 102 and 15..... \$ 6,544.38

Summary

Income Tax Under Sections 13 and 15	\$13,444.34
Income Tax Under Sections 102 and 15	6,544.38
Correct Income Tax Liability.....	\$19,988.72
Income Tax Assessed:	
Original, Account No. October 420010	10,970.93
Deficiency of Income Tax.....	\$ 9,017.79

Computation of Excess Profits Net Income
Taxable Year Ended June 30, 1941

Excess Profits Net Income Disclosed by Return		\$34,741.27
Additions:		
(a) Compensation of Officers.....	\$10,000.00	
(b) Proceeds from Sale of Scrap Omitted from Income Reported	1,873.16	11,873.16
Total		\$46,614.43
Deductions:		
(c) Declared Value Excess-Profits Tax	\$ 1,567.27	
(d) Income Tax	2,473.41	4,040.68
Excess Profits Net Income Adjusted..		\$42,573.75

Explanation of Adjustments

(a) and (b) These adjustments have been previously explained.

(c) The deduction claimed for declared value excess-profits tax is increased by the amount of the deficiency thereof as shown above in the computation of declared value excess profits tax.

(d) The deduction claimed for income tax is increased as shown above in the computation of income tax under Sections 13 and 15, I.R.C.

Adjustment to Average Base Period Net Income Where There
Were Increased Earnings in the Last Half
of the Base Period

Taxable Year Ended June 30, 1941

Average Base Period Net Income Where There Were Increased Earn- ings in the Last Half of the Base Period as Disclosed by Return.....	\$12,322.13
---	-------------

Deduction:

(a) Elimination of Short-Term Capital Net Loss	500.00
---	--------

Average Base Period Net Income Where There Were Increased Earn- ings in the Last Half of the Base Period Adjusted	\$11,822.13
--	-------------

Explanation of Adjustment

(a) This adjustment is due to the elimination of a short-term capital net loss of \$2,000.00 sustained upon the sale of securities during the base period year ended June 30, 1938.

Computation of Excess Profits Credit

Taxable Year Ended June 30, 1941

Average Base Period Net Income.....	\$11,822.13
95% of Average Base Period Net In- come	\$11,231.02
Excess Profits Credit.....	\$11,231.02

Computation of Adjusted Excess Profits Net Income		
Taxable Year Ended June 30, 1941		
Excess Profits Net Income.....		\$42,573.75
Less: Exemption	\$ 5,000.00	
Excess Profits Credit.....	11,231.02	16,231.02
		<hr/>
Adjusted Excess Profits Net Income..		\$26,342.73
Computation of Excess Profits Tax		
Taxable Year Ended June 30, 1941		
Adjusted Excess Profits Net Income..		\$26,342.73
Excess Profits Tax:		
25% of \$20,000.00.....	\$ 5,000.00	
30% of \$ 6,342.73.....	1,902.82	
		<hr/>
Correet Excess Profits Tax Liability..		\$ 6,902.82
Excess Profits Tax Assessed:		
Original, Account No. October		
400010		4,508.81
		<hr/>
Deficiency of Excess Profits Tax.....		\$ 2,394.01
Adjustments To Net Income		
Taxable Year Ended June 30, 1942		
Net Income as Disclosed by Return....		\$91,747.72
Unallowable Deduction and Addi-		
tional Income:		
Compensation of Officers.....	\$10,000.00	
Proceeds from Sale of Scrap		
Omitted from Income Re-		
ported	1,716.36	11,716.36
		<hr/>
Net Income Adjusted		\$103,464.08

Explanation of Adjustments

These adjustments have been previously explained.

Computation of Declared Value Excess-Profits Tax

Taxable Year Ended June 30, 1942

Net Income Adjusted	\$103,464.08
Less: 10% of \$400,900.00 value of Capital Stock as Declared in the Capital Stock Tax Return for the Year Ended June 30, 1942....	40,090.00
Net Income Subject to Declared Value Excess-Profits Tax.....	\$ 63,374.08
Amount Taxable at 6.6% (5% of \$400,900.00)	20,045.00
Amount Taxable at 13.2%.....	\$ 43,329.08
Declared Value Excess-Profits Tax:	
6.6% of \$29,045.00.....	\$ 1,322.97
13.2% of \$43,329.08.....	5,719.44
Correct Declared Value Excess-Prof- its Tax Liability.....	\$ 7,042.41
Declared Value Excess-Profits Tax Assessed:	
Original, Account No. October 420015	5,495.85
Deficiency of Declared Value Excess- Profits Tax.....	\$ 1,546.56

Computation of Excess Profits Net Income

Taxable Year Ended June 30, 1942

Excess Profits Net Income as Disclosed by Return		\$ 86,184.85
Additions:		
(a) Compensation of Officers.....	\$10,000.00	
(b) Proceeds from Sale of Scrap Omitted from Income Reported	1,716.36	11,716.36
	<hr/>	<hr/>
Total		\$ 97,901.21
Deduction:		
(c) Declared Value Excess-Profits Tax.....		1,546.56
		<hr/>
Excess Profits Net Income Adjusted..		\$ 96,334.65

Explanation of Adjustments

(a) and (b): These adjustments have been previously explained.

(c) The deduction claimed for declared value excess-profits tax is increased by the amount of the deficiency thereof as shown above in the computation of declared value excess-profits tax.

Adjustment to Average Base Period Net Income

Where There Were Increased Earnings in the Last Half of the Base Period

Taxable Year Ended June 30, 1942

Average Base Period Net Income Where There Were Increased Earnings in the Last Half of the Base Period as Disclosed by Return		\$ 14,168.53
Deduction:		
(a) Elimination of Short-Term Capital Net Loss.....		500.00
		<hr/>
Average Base Period Net Income Where There Were Increased Earnings in the Last Half of the Base Period Adjusted.....		\$ 13,668.53

Explanation of Adjustment

(a) This adjustment is due to the elimination of a short-term capital net loss of \$2,000.00 sustained upon the sale of securities during the base period year ended June 30, 1938.

Computation of Excess Profits Credit

Taxable Year Ended June 30, 1942

Average Base Period Net Income.....	\$ 13,668.53
95% of Average Base Period Net Income	\$ 12,985.10
Excess Profits Credit	\$ 12,985.10

Computation of Adjusted Excess Profits Net Income

Taxable Year Ended June 30, 1942

Excess Profits Net Income Adjusted..	\$ 96,354.65
Less: Exemption.....	\$ 5,000.00
Excess Profits Credit.....	12,985.10
	<hr/>
Adjusted Excess Profits Net Income..	\$ 78,369.55

Computation of Excess Profits Tax

Taxable Year Ended June 30, 1942

Adjusted Excess Profits Net Income..	\$ 78,369.55
Excess Profits Tax:	
35% of \$20,000.00.....	\$ 7,000.00
40% of \$30,000.00.....	12,000.00
45% of \$28,369.55.....	12,766.30
	<hr/>
Correct Excess Profits Tax Liability..	\$ 31,766.30
Excess Profits Tax Assessed:	
Original, Account No. October 400011	26,976.14
	<hr/>
Deficiency of Excess Profits Tax.....	\$ 4,790.16

Computation of Income Tax

Taxable Year Ended June 30, 1942

Tax Under Sections 13 and 15, Internal Revenue Code:

Net Income		\$103,464.08
Less: Declared Value Excess		
Profits Tax.....	\$ 7,042.41	
Excess Profits Tax.....	31,766.30	38,808.71
		<hr/>
Surtax Net Income.....		\$ 64,655.37
Normal Tax Net Income.....		\$ 64,655.37
Income Tax:		
Normal Tax:		
24% of \$64,655.37.....		\$ 15,517.29
Surtax:		
6% of \$25,000.00.....	\$ 1,500.00	
7% of \$39,655.37.....	2,755.88	4,275.88
		<hr/>
Total Income Tax Under Sec-		
13 and 15	19,793.17	

Tax Under Section 102, Internal Revenue Code:

Net Income.....		\$103,464.08
Less: Declared Value Excess-		
Profits Tax.....	\$ 7,042.41	
Income tax Under Sections		
13 and 15	19,793.17	
Excess Profits Tax.....	31,766.30	58,601.88
		<hr/>
Section 102 Net Income.....		\$ 44,862.20
Less: Basic Surtax Credit.....		11,716.36
		<hr/>
Undistributed Section 102 Net		
Income		\$ 33,145.84
Income Tax:		
27½% of \$33,145.84.....	\$ 9,115.11	
Total Income Tax Under Sec-		
tion 102.....		\$ 9,115.11

Summary

Income Tax Under Section 13 and 15	\$ 19,793.17
Income Tax Under Section 102.....	9,115.11
	<hr/>
Correct Income Tax Liability.....	\$ 18,908.28
Income Tax Assessed:	
Original, Account No. October	
420015	18,125.48
	<hr/>
Deficiency of Income Tax.....	\$ 10,782.80
Received and filed Dec. 11, 1944.	

[Title of Tax Court and Cause.]

ANSWER

The Commissioner of Internal Revenue, by his attorney, J. P. Wenchel, Chief Counsel, Bureau of Internal Revenue, for answer to the petition of the above-named taxpayer, admits and denies as follows:

1 and 2. Admits the allegations contained in paragraphs 1 and 2 of the petition.

3. Admits that the taxes in controversy are income, excess-profits, declared value excess-profits and Section 102 taxes for the fiscal years ended June 30, 1941, and June 30, 1942; denies the remaining allegations contained in paragraph 3 of the petition.

4. Denies the allegations of error contained in subparagraph (A) and (B) of paragraph 4 of the petition. [17]

5. Denies the allegations contained in paragraph 5 of the petition, and all subdivisions thereof.

6. Denies each and every allegation contained in the petition not hereinbefore specifically admitted or denied.

Wherefore, it is prayed that the determination of the Commissioner be approved.

/s/ J. P. WENCHEL ECC
Chief Counsel, Bureau of Internal Revenue.

Of Counsel:

B. H. NEBLETT,
Division Counsel.

E. C. CROUTER,

E. A. TONJES,

Special Attorneys, Bureau of Internal Revenue. [18]

The Tax Court of the United States

Docket No. 6695

KENNEDY NAMEPLATE COMPANY, a Corporation,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

1. Petitioner, a corporation, was organized in 1923 by two individuals, each of whom except for one qualified share, acquired 50 per cent of petitioner's capital stock. These individuals were elected officers of petitioner and have continued as such to and through the taxable years ended June 30, 1941 and 1942. Each officer devoted all of his time to petitioner's business. In 1940 petitioner increased the salaries of each officer up to \$12,000 per annum which was a substantial increase over previous years. During each taxable year petitioner paid each officer \$12,000 as a regular salary, \$5,000 as a bonus and approximately \$900 as proceeds from the sale of scrap. Petitioner declared or paid no dividends, as such, since the fiscal year ended June 30, 1938. Held, petitioner is not entitled to deduct under section 23 (a)(1)(A), I.R.C., as reasonable com-

pensation for services rendered by its two officers any amount in excess of the regular salaries paid each year in the total amount of \$24,000 and proceeds from the scrap sales; held, further, the payments of the bonuses were in the nature of dividend distributions on stock and not deductible by petitioner as ordinary and necessary expenses under section 23 (a)(1)(A). [19]

2. Petitioner at the time of incorporation in 1923 took over a name plate business then being conducted by a partnership. During the taxable years its business included the production of many items in addition to name plates which were sold largely to the airplane industry. During the taxable years petitioner was badly in need of a new building, a new press and other equipment and adopted a policy of accumulating its earnings for that purpose. Held, that during the taxable years ended June 30, 1941 and 1942, petitioner was not availed of for the purpose of preventing the imposition of the surtax upon its shareholders through the medium of permitting its earnings or profits to accumulate instead of being distributed to its stockholders and it is not liable for the surtax imposed by section 102 of the Internal Revenue Code.

Preston D. Orem, Esq., and C. Earle Memory, C.P.A., for the petitioner.

E. A. Tonjes, Esq., for the respondent.

MEMORANDUM FINDINGS OF FACT AND OPINION

The respondent determined deficiencies for the taxable years ended June 30, 1941, and June 30, 1942, as follows:

Year	Income Tax	Declared Value Excess Profits Tax	Excess Profits Tax
1941	\$ 9,017.79	\$1,567.27	\$2,394.01
1942	10,782.80	1,546.56	4,790.16

In a statement attached to the deficiency notice the respondent, among other things, advised petitioner as follows:

It is held that the sums paid to your officers as alleged compensation, and deducted from gross income in computing your taxable net income, for the taxable years ended June 30, 1941 and 1942, exceed reasonable allowances for services rendered in such years within the purview of section 23 of the Internal Revenue Code to the following extent: [20]

Taxable Year Ended June 30, 1941

Item of Alleged			
Compensation		J. W. Hayek	W. J. Kennedy
Bonus		\$5,000.00	\$5,000.00
Proceeds from sale of scrap material retained by officer..		936.58	936.58
		<hr/>	<hr/>
Amounts deemed excessive.....		\$5,936.58	\$5,936.58
Taxable Year Ended June 30, 1942			
Bonus		\$5,000.00	\$5,000.00
Proceeds from sale of scrap material retained by officer..		858.18	858.18
		<hr/>	<hr/>
Amounts deemed excessive.....		\$5,858.18	\$5,858.18

It is held that for each of the taxable years ended June 30, 1941 and 1942, you were availed of for the purpose of preventing the imposition of surtax upon your shareholders through the medium of permitting your earnings and/or profits to accumulate beyond the reasonable needs of your business instead of being divided or distributed. Accordingly, surtax is imposed upon you for each of said taxable years ended June 30, 1941, and June 30, 1942, under the provisions of section 102 of the Internal Revenue Code.

Petitioner by appropriate assignments of error contests all of the above-mentioned adjustments and holdings of the respondent.

In determining the average base period net income for each of the taxable years here involved the respondent eliminated in each year the amount of \$500 from the average base period net income as disclosed by petitioner's returns. Petitioner does not contest these eliminations.

Findings of Fact

Petitioner is a corporation. It was incorporated under the laws of the State of California on August 19, 1923, and has its principal office and place of business in the City of Los Angeles. It filed its corporation income and excess profits tax returns for the fiscal years ended June 30, 1941, and June 30, 1942, with the collector for the sixth collection district at Los Angeles. [21]

Joseph W. Hayek has been in the name plate business since 1907. From 1907 to 1917 he either managed name plate companies or the name plate departments of various companies. In 1917 he started a name plate business in Minneapolis, Minnesota, under the name of Hayek Nameplate & Novelty Company. In 1921 he sold this business to William James Kennedy and Kennedy's uncle. Kennedy and his uncle moved the business to Los Angeles, California, and began to operate it as a partnership under the name of Kennedy Nameplate Company. Hayek originally became an employee of the partnership and had charge of the production end of the business. Soon thereafter Kennedy's uncle sold his 50 per cent interest in the partnership to Hayek and in 1923 Hayek and Kennedy organized the petitioner herein. The business of the partnership was transferred to petitioner in exchange for the latter's stock. From the time of organization to and through the taxable years here involved Hayek has been the president and a director of petitioner and Kennedy has been the secretary-treasurer and a director. Both men have devoted their entire time to petitioner's business and have engaged in no outside business activities.

At the time petitioner was organized it issued 1,251 shares of its stock to Hayek, 1,251 shares to Kennedy, and 1 share to a Mr. Frank who became a director along with Hayek and Kennedy. Petitioner had only three directors. Frank was later succeeded by D. R. Koelling who then became the third director. The stock had a par value of \$10

per share. During the taxable years here in question the stock that was issued to Hayek was owned by him as his separate property and the stock that was issued to Kennedy was either owned by him as his separate property or by him and his wife, Alice L. Kennedy, as community property. [22]

Kennedy was employed by various companies in New York City, Chicago, and in South America from 1912 to 1921 when he first engaged in the name plate business. He had had quite extensive experience as an executive and manager and in sales promotion both in the United States and in South America.

From the time petitioner was organized to and through the taxable years here involved Hayek and Kennedy divided the important managerial functions of petitioner's business between them. Hayek was in complete charge of production, supervising the work of men employed in several different trades including art, die making, engraving, photography, etching, plating, lithography, decalcomania manufacture and punch press operations. He also employed a portion of the technical personnel. He perfected many new processes and techniques including a new method for camera work, the elimination of certain etching and lithographic operations, die making improvements, new engraving methods, new chemical solutions and new uses for chemical solutions, new processes for plastics and fibre, fluorescent plates and many others. He and Kennedy together devised a new type of con-

vexor to operate under a bank of infra red light which has been quite successful. Kennedy was in complete charge of all departments and activities of petitioned except production, including sales, advertising, price figuring, employment of a portion of the technical personnel, collections, purchases, finances and also keeping in constant touch with new technological developments and processes.

During the taxable years ended June 30, 1941 and June 30, 1942, Hayek worked from 65 to 75 hours per week as compared with about 45 hours in 1939. Many times he worked on Sunday during the war and more than once he was required to work all night on important war jobs. Kennedy worked about 54 hours per week during the taxable years as compared with about 45 hours per week during 1939 and 1940. [23]

The business of petitioner during the years 1941 and 1942 included the production of many items in addition to name plates, including scales, dials, instruction and designation plates, luminous, fluorescent and phosphorescent plates and other articles of similar nature which were sold largely to the airplane industry. It was necessary to substitute plastics and fibres for metals in manufacturing many products because of the shortage of metals and the necessity for conserving strategic materials. The business of the company during these years also involved the use of radium and black light. Many problems arose due to the fumes caused by

the use of certain materials, allergies and radio-activity. Government inspection during the war was very rigid, requiring greater accuracy in production than in prior years.

The by-laws of petitioner empowered the board of directors to appoint and remove all officers of the company, prescribe their duties and fix their compensation.

The minutes of the regular meeting of the board of directors of petitioner held on April 30, 1940 provide in part as follows:

On motion of Jos. W. Hayek, seconded by D. R. Koelling, it was voted to increase the salary of W. J. Kennedy, to \$12,000 per year, retroactive to July 1st, 1939.

W. J. Kennedy then relinquished the chair to Jos. W. Hayek, and moved, seconded by D. R. Koelling, that the salary of Jos. W. Hayek be increased to \$12,000 per year, retroactive to July 1st, 1939.

The minutes of the regular meeting of the board of directors of petitioner held on June 11, 1941 provide in part as follows:

On motion of W. J. Kennedy, seconded by D. R. Koelling, a bonus of \$5,000 was voted to Jos. W. Hayek and W. J. Kennedy.

Petitioner's net sales, officers' compensation (Hayek and Kennedy only), net income before Federal taxes on income, Federal taxes on income,

and net profits for the fiscal years ended June 30, 1936 to June 30, 1942, inclusive, were as follows:

Year Ended June 30	Net Sales	Officers' Compensation	Net Income before Federal Taxes	Federal Taxes on Income	Net Profit
1936	\$ 82,153.49	\$ 6,542.00	\$16,430.61	\$ 2,925.79	\$13,504.82
1937	98,354.42	15,000.00	13,870.53	2,961.67	10,908.86
1938	109,464.23	15,322.40	6,387.47	1,526.50	4,860.97
1939	109,966.49	15,183.30	10,164.23	1,347.99	8,816.24
1940	151,446.43	24,194.80	15,862.53	2,145.75	13,716.78
1941	256,451.30	34,000.00	46,942.07	16,709.61	30,232.46
1942	363,912.88	34,000.00	91,747.72	50,597.47	41,150.25

Beginning in 1931 petitioner began paying bonuses to certain of its employees. During the taxable years such bonuses approximately \$12,000 to \$14,000 per year. During the fiscal years ended June 30, 1937, to June 30, 1942, inclusive, petitioner's employees numbered 39, 36, 37, 53, 73 and 90, respectively.

Petitioner accumulated certain scrap from time to time which is the metal that was left over from the various jobs. It is usually referred to as "overs on jobs" and is sold as scrap. The proceeds from the sales of scrap by petitioner amounted to \$1,873.16 for the fiscal year ended June 30, 1941, and \$1,716.36 for the fiscal year ended June 30, 1942. One-half of these amounts was paid over to Hayek and one-half to Kennedy, who, together with their respective wives, reported the amounts in their individual income tax returns as income from the sale of scrap. Petitioner did not return any of the proceeds from the sales of scrap as income and neither

did it deduct any amount as compensation, or otherwise, on account of the said proceeds that were paid over to Hayek and Kennedy. The proceeds from the sale of scrap was a part of petitioner's gross income and should have been returned by petitioner as such. It is the practice in the name plate industry to permit officers to sell scrap and to regain the proceeds from such sales as a bonus or additional compensation. Everywhere that Hayek ever worked he always got the scrap or part of [25] the scrap. In 1916, when he was working for a Minneapolis concern, his salary was \$4,420 plus all the scrap except the scrap from sterling silver. In 1930 he was offered a position at an annual salary of \$12,000 plus 20 per cent of the scrap.

During the years 1941 and 1942 there were only two or three firms besides petitioner in the name plate business in the Los Angeles area. The principal competitor of petitioner in the Los Angeles area was Miller Dial & Nameplate Company. During the years 1941 and 1942 Miller Dial & Nameplate Company was a partnership composed of two brothers, Charles W. Miller and John Dawson Miller. The duties of Charles in the partnership were very similar to those of Kennedy in petitioner and the duties of John in the partnership were very similar to those of Hayek in petitioner. The sales of Miller Dial & Nameplate Company for the calendar year 1941 were approximately \$156,000 and for the calendar year 1942 they were approximately

\$338,000. No salaries were paid to the partners in Miller Dial & Nameplate Company for the year 1941; the partners simply made withdrawals as needed. For the year 1942 the salary of Charles was \$24,000 and that of John was \$18,000.

During February or March of the year 1943 the Northern Engraving Company of Racine, Wisconsin, offered to purchase a 51 per cent control of the business of petitioner and to retain the services of Hayek and Kennedy for a period of two years. This offer was rejected.

Petitioner has declared or paid no dividends, as such, since the fiscal year ended June 30, 1938. [26]

A reasonable allowance for salaries or other compensation for personal services actually rendered to petitioner by each of its officers, Hayek and Kennedy, during each of the taxable years ended June 30, 1941, and June 30, 1942, was the basic salary paid to each officer in each year in the respective amount of \$12,000 plus the proceeds from the sale of scrap in each of the taxable years paid to those two respective officers. The amounts of \$5,000 paid to each officer in the taxable years ended June 30, 1941, and June 30, 1942, were in the nature of dividend distributions on stock.

Petitioner's surplus, increase (or decrease) in surplus, working capital and increase (or decrease) in working capital for the years ended June 30,

1936, to March 31, 1946, inclusive, were as follows
(Note: Decreases are shown in parentheses):

Year Ended June 30	Surplus	Increase (or decrease) in Surplus	Working Capital	Increase (or decrease) in Working Capital
1936	\$ 26,141.88		\$ 35,201.14	
1937	32,775.62	\$ 6,633.74	41,234.91	\$ 6,033.77
1938	30,021.08	(2,754.54)	26,405.09	(14,829.80)
1939	39,333.04	9,311.96	32,425.69	6,020.60
1940	42,183.61	2,850.57	36,864.01	4,438.32
1941	72,423.25	30,239.64	50,740.22	10,876.21
1942	114,185.01	41,761.76	75,153.36	24,413.14
1943	135,056.32	20,871.31	69,610.34	(1,543.00)
1944	151,981.40	16,925.08	89,518.16	18,907.82
1945	162,000.47	10,019.07	108,910.14	16,391.98
1946 (9 months)	147,073.45	(14,972.02)	92,818.75	(13,091.30)
Total net increases..		\$120,931.57		\$57,617.60

At all times from June 30, 1936, to March 31, 1946, petitioner's capital stock outstanding was 2,503 shares of the par value of \$25,030. During the fiscal years ended June 30, 1936, 1937 and 1938, petitioner declared and paid dividends in the amounts of \$1,000.80, \$4,311 and \$5,006, respectively.

Petitioner's comparative balance sheets for the fiscal years ended June 30, 1936 to June 30, 1940, inclusive, are as follows:

ASSETS	1936	1937	1938	1939	1940
Cash and Bank Accounts.....	\$ 20,595.16	\$ 15,311.14	\$ 14,561.85	\$ 15,189.21	\$ 18,305.04
Corporation Stock.....		10,209.20			
Accounts Receivable.....	13,469.11	13,561.78	11,626.25	11,878.28	17,015.22
Inventories	3,656.07	4,937.87	6,674.30	10,511.31	9,025.46
Plant and Equipment.....	47,053.77	51,491.79	56,093.81	56,832.32	60,854.20
Prepaid Expenses.....	308.60	186.20	817.63	543.87	338.91
Deferred Charges and Goodwill.....	10,866.21	10,866.21	10,866.21	10,866.21	—
Totals	\$ 95,948.92	\$106,564.19	\$100,640.05	\$105,821.20	\$105,538.83
LIABILITIES AND CAPITAL					
Current Liabilities.....	\$ 2,519.20	\$ 2,785.08	\$ 4,930.81	\$ 3,805.12	\$ 5,335.96
Federal Taxes on Income.....	—	—	1,526.50	1,347.99	2,145.75
Due to Employees.....	23,652.46	31,240.00	22,141.30	17,017.54	17,017.54
Mortgage Payable.....	6,000.00	—	—	—	—
Depreciation Reserves.....	12,605.38	14,733.49	16,990.36	19,287.51	13,825.97
Capital Stock.....	25,030.00	25,030.00	25,030.00	25,030.00	25,030.00
Surplus	26,141.88	32,775.62	30,021.08	39,333.04	42,183.61
Totals	\$ 95,948.92	\$106,564.19	\$100,640.05	\$105,821.20	\$105,538.83

Petitioner's comparative balance sheets for the fiscal years ended June 30, 1941 to June 30, 1945, inclusive, are as follows:

ASSETS	1941	1942	1943	1944	1945
Cash & Bank Accounts.....	\$ 33,056.18	\$ 82,825.15	\$ 94,419.12	\$ 59,452.71	\$ 79,396.41
Treasury Notes.....	—	—	—	25,225.42	25,182.28
Accounts Receivable.....	28,942.09	33,756.89	31,055.08	21,737.12	17,255.83
Inventories.....	17,513.90	21,434.86	14,429.96	12,912.47	9,487.66
Plant & Equipment.....	74,593.98	79,512.41	103,278.34	106,777.58	106,174.01
Prepaid Expenses.....	451.14	323.82	319.09	286.40	350.66
Boyle Avenue Property.....	8,126.06	8,008.55	7,891.04	7,773.53	7,656.02
Post War Tax Refunds.....	—	—	3,887.20	4,695.01	4,420.28
Totals.....	\$162,683.35	\$225,861.68	\$255,279.83	\$238,860.24	\$249,923.15
LIABILITIES & CAPITAL					
Current Liabilities.....	\$ 12,062.34	\$ 12,877.58	\$ 17,681.15	\$ 16,175.02	\$ 21,843.34
Federal Taxes on Income.....	16,709.61	49,985.96	41,112.67	13,634.54	3,568.70
Notes Payable.....	3,000.00	3,000.00	10,500.00	—	—
Due to Employees.....	16,997.54	—	—	—	—
Depreciation Reserves.....	16,460.61	20,783.13	25,899.69	32,039.28	37,480.64
Capital Stock.....	25,030.00	25,030.00	25,030.00	25,030.00	25,030.00
Surplus.....	72,423.25	114,185.01	135,056.32	151,981.40	162,000.47
Totals.....	\$162,683.35	\$225,861.68	\$225,279.83	\$238,860.24	\$249,923.15

Petitioner's balance sheet as of March 31, 1946, is as follows:

ASSETS

Cash & Bank Accounts.....	\$ 40,329.53
Treasury Notes	25,026.00
Corporation Stock	9,750.00
Accounts Receivable	16,681.81
Inventories	20,549.81
Plant & Equipment.....	107,177.14
Prepaid Expenses	1,402.76
Boyle Avenue Property.....	7,567.91
Post War Tax Refunds.....	4,420.28
Total.....	<u>\$232,905.24</u>

LIABILITIES & CAPITAL

Current Liabilities	\$ 19,518.40
Depreciation Reserve	41,283.39
Capital Stock	25,030.00
Surplus	147,073.45
Total.....	<u>\$232,905.24</u>

An analysis of petitioner's surplus account from July 1, 1935, to and including March 31, 1946, is as follows (Note: All years are fiscal years ending June 30th, except 1946, which is a 9 months period ending March 31, 1946):

Year	Balance Beginning of Year	Add Profits For Year	Add (Or Deduct) Net Income Tax Adjustments	Add (Or Deduct) Other Adjustments	Deduct Dividends Paid	Balance End Of Year
1936.....	\$ 10,920.21	\$ 13,504.82	\$ 2,717.65	—	\$1,000.80	\$ 26,141.88
1937.....	26,141.88	10,908.86	35.88	—	4,311.00	32,775.62
1938.....	32,775.62	4,860.97	(\$2,961.67)	\$ 352.16	5,006.00	30,021.08
1939.....	30,021.08	8,816.24	—	495.72	—	39,333.04
1940.....	39,333.04	13,716.78	—	(10,866.21)	—	42,183.61
1941.....	42,183.61	30,232.46	—	7.18	—	72,423.25
1942.....	72,423.25	41,150.25	611.51	—	—	114,185.01
1943.....	114,185.01	21,482.82	(611.51)	—	—	135,056.32
1944.....	135,056.32	16,925.08	—	—	—	151,981.40
1945.....	151,981.40	10,019.07	—	—	—	162,000.47
1946.....	162,000.47	(14,927.02)	—	—	—	147,073.45

An analysis of petitioner's plant and equipment account from July 1, 1936, to and including March 31, 1946, indicates that petitioner made the following additions thereto during each year and also wrote off certain assets in amounts as follows:

Year Ended June 30	Additions	Amounts Written Off
1937	\$ 4,438.02	None
1938	4,602.02	None
1939	738.51	None
1940	11,573.14	\$ 7,551.26
1941	14,199.03	459.25
1942	5,239.37	320.94
1943	24,199.68	433.75
1944	3,544.49	45.25
1945	680.31	1,283.88
1946 (9 months).....	1,003.13	None
Totals.....	<u>\$70,217.70</u>	<u>\$10,094.33</u>

Before and during the years 1941 and 1942, the officers of petitioner planned a considerable expansion program for the increase of its plant facilities. These plans included a new modern building with a mezzanine floor designed to fit the manufacturing needs of petitioner which would cost between \$150,000 and \$250,000. It was estimated by petitioner's officers that this new building would decrease petitioner's costs of manufacture from three to five per cent and provide badly needed space for the restoration of discontinued facilities and the in-

stallation of new facilities. Erection of a new building is still planned by petitioner and is essential.

During December of 1940, petitioner purchased a site on Boyle Avenue in an industrial section one and one-half miles from its existing plant for \$8,126.06. Prior to the purchase, petitioner had investigated the Boyle Avenue property and other properties for the purpose of finding a satisfactory location for a new plant. The Boyle Avenue property was purchased for that purpose. Because building contractors were busy on war contracts in 1941, it proved not practicable to put up a building on Boyle Avenue at that time. Later, two large plants of other companies were erected near the Boyle Avenue site, who employed about 6,500 to 7,000 employees. As this situation resulted in a parking problem and traffic congestion around the Boyle Avenue property it was rendered less suitable for the purpose of the erection of a plant for petitioner, although the property had generally become more valuable.

Petitioner leased the Boyle Avenue property to a tenant which lease has now expired and the same tenant is occupying the property on a month to month basis. Petitioner is now endeavoring to exchange the Boyle Avenue site for a property more suitable for the fulfillment of its building program.

When petitioner moved to its present plant in 1928 the cost of moving its machinery to that plant was from \$3,000 to \$4,000. Petitioner now has from eight to ten times as much equipment which will have to be moved to its new building.

Petitioner has a large lithographic press which it purchased about 1926. The press is a Voss and Lang press which was made in 1874. This press is inadequate, dilapidated and slow. Petitioner is badly in need of a new lithographic press. During 1941 or 1942, Hayek made a trip East and investigated lithographic presses at the plants where they were being manufactured. He recommended the purchase of an R. J. Hoe press at a cost of \$35,000 to \$55,000 f.o.b. Newark, New Jersey, plus \$3,000 to \$5,000 for shipping and installation costs. Petitioner still badly needs the Hoe press but the present building is not large enough and there is not adequate space for the Hoe press. During the war, Hoe & Company were only taking Government orders and could not make delivery of a press to petitioner. When petitioner is able to purchase the Hoe press and install it for use, it can take large tin sign orders which cannot be accepted at present because of the inadequate press in use.

Petitioner planned in 1941 and 1942 to take out all of its present ovens and replace them with infra red conveyors such as the one invented by petitioner's officers and already in use in 1941. The cost was estimated to be \$12,000 to \$15,000. It is planned to make these installations as soon as there is room for them. Such installations will materially reduce costs and improve the appearance of the jobs. [32]

Petitioner had to tear out its plating department in 1941 because of Government restrictions and because the space occupied by the plating de-

partment was required for degreasing of material on Government contracts. Since 1942 petitioner has assembled a nickel plating plant but has to subcontract out all other plating. This causes delays in deliveries and reduces profits. Additional plating facilities are required at present and would cost \$15,000 to \$20,000.

During 1941 and 1942, petitioner planned to obtain a license for color anodizing from the Aluminum Corporation of America at a cost of \$5,000 for the license plus \$10,000 to \$12,000 for the required color anodizing plant consisting of tanks, dynamos, lines, anodes, etc. Due to war requirements, petitioner had no available space for the proposed installation but still contemplates securing the license and putting in the plant as soon as the space is available. This type of facilities is required to keep petitioner's service to its customers complete and continuous.

Petitioner also planned during 1941 and 1942 to go further into the field of plastics manufacture, put in an adequate hydraulic press, a good plastic press and other miscellaneous equipment which would cost around \$25,000 at first and more later.

During 1941 and 1942, petitioner anticipated an eventual cessation of war hostilities and that a reconversion period would follow. Petitioner believed it would lose all of its war customers, and have to find new customers engaged in civilian work, that there would be a loss from its operations during a period from one to two years after the

cessation of hostilities, that existing contracts would be cancelled and cost percentages would be greater during the reconversion period. During the nine months ended March 31, 1946 (the greater portion of that period being after war operations [33] had ceased) petitioner sustained a net loss from operations of \$14,927.02 and a decrease in working capital of \$13,091.39. Kennedy believes that the reconversion period will last at least one more year after March 31, 1946, during which period it is probable a loss will be sustained.

Petitioner's original plant building erected in 1928 and the first addition thereto added in 1929 or 1930 were financed partially by first and second mortgages. When the second mortgage matured in 1931, the mortgagee refused to renew it. Petitioner was unable to refinance the mortgage in Los Angeles and had to refinance it in Chicago in part and by a loan from Hayek in part. There was danger of a foreclosure which would have put petitioner out of business in 1931.

After 1931 petitioner adopted a policy of financing all capital additions, such as building sites, additions to buildings, machinery and equipment from its earnings entirely rather than in part through loans. This policy was continued through 1941 and 1942 and up to the present time, petitioner paying cash for all of its capital additions to plant, machinery and equipment, and also planning to finance future contemplated new plant and machinery and equipment additions from its working capital.

During the taxable years here involved petitioner was not a mere holding or investment company. Petitioner did not during the taxable years here in question permit its earnings or profits to accumulate beyond the reasonable needs of its business. During the taxable years here involved petitioner was not availed of for the purpose of preventing the imposition of the surtax upon its shareholders or the shareholders of any other corporation through the medium of permitting its earnings or profits to accumulate instead of being divided or distributed. [34]

Opinion

Black, Judge: There are three issues involved in this proceeding. The first is whether the respondent erred in disallowing as excessive compensation the bonuses which petitioner paid to its two officers during each of the taxable years here involved. The second is whether the respondent erred in increasing petitioner's income for each of the taxable years by the amount of the proceeds from the sale of scrap which had all been paid over to its two officers and returned by them and their respective wives as taxable income and whether if such proceeds should be taken into petitioner's gross income, petitioner should be allowed as an additional amount for salary deductions, the amounts so paid over to Kennedy and Hayek. The third is whether the respondent erred in determining that petitioner was subject to the surtax on corporations imposed by section 102 of the Internal Revenue

Code, as amended, for each of the taxable years ended June 30, 1941 and June 30, 1942.

The first two issues are closely related and will be considered together. During each of the taxable years here involved petitioner paid each of its two officers a \$5,000 bonus and also paid over to each of its two officers 50 per cent of the proceeds from the sale of scrap. Petitioner did not return any of the proceeds from the sale of scrap as income or deduct any amount on account of the payment of such proceeds to its officers. Hayek and Kennedy and their respective wives each reported one-fourth of such proceeds as income from the sale of scrap. Petitioner in substance now concedes that it should have reported the proceeds from the sale of scrap as its income, but contends that it should also have deducted a like amount as compensation paid to its two officers in addition to the bonuses and regular salaries. During each of the taxable years here involved petitioner deducted \$10,000 on account of the bonuses paid and [35] \$24,000 on account of the regular salaries paid to each of its two officers. The respondent allowed as deductions the regular salaries; disallowed as deductions the bonuses; included in petitioner's income the proceeds from the sale of scrap; and contends that in no event is petitioner entitled to deductions from gross income as reasonable compensation paid its officers any amount in excess of the regular salaries. The first two issues, therefore, resolve themselves into the single question of whether petitioner is entitled to deduct under sec-

tion 23 (a)(1)(A) of the Internal Revenue Code, as amended,¹ as "a reasonable allowance for salaries or other compensation for personal services actually rendered" all the amounts paid to its two officers during the taxable years here involved. These amounts are as follows:

SEC. 23. DEDUCTIONS FROM GROSS INCOME.

In computing net income there shall be allowed as deductions:

(a) Expenses.

(1) Trade or Business Expenses.

(A) In General. All the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business, including a reasonable allowance for salaries or other compensation for personal services actually rendered; traveling expenses (including the entire amount expended for meals and lodging) while away from home in the pursuit of a trade or business; and rentals or other payments required to be made as a condition to the continued use or possession, for purposes of the trade or business, of property to which the taxpayer has not taken or is not taking title or in which he has no equity. [36]

	Taxable Year Ended June 30, 1941	Taxable Year Ended June 30, 1942
Regular salary to Hayek.....	\$12,000.00	\$12,000.00
Regular salary to Kennedy.....	12,000.00	12,000.00
Bonus to Hayek.....	5,000.00	5,000.00
Bonus to Kennedy.....	5,000.00	5,000.00
Scrap proceeds to Hayek.....	936.58	858.18
Scrap proceeds to Kennedy.....	936.58	858.18
Totals.....	\$35,873.16	\$35,716.36

The respondent concedes that the regular salaries paid to both Hayek and Kennedy are deductible. He contests only the bonuses and scrap proceeds paid to each officer for each year. He contends that these latter payments were in effect dividends in disguise. Petitioner contends that the total amounts paid represented reasonable compensation for personal services actually rendered. The question presented is one of fact and the burden of proof is upon petitioner. *Botany Worsted Mills vs. United States*, 278 U. S. 282; *H. Levine & Bros., Inc., vs. Commissioner*, 101 Fed. (2d) 391.

Section 19.23(a)-6 of Treasury Regulations 103, provides among other things that the test of deductibility in case of compensation payments is whether they are reasonable and are in fact payments purely for services. It uses the following as an illustration:

* * * An ostensible salary paid by a corporation may be a distribution of a dividend on stock. This is likely to occur in the case of a corporation having few shareholders, practically all of whom draw salaries. If in such a case the salaries are in excess of those ordinarily paid for similar services, and the excessive payments correspond or bear a close relationship to the stock holdings of the officers or employees, it would seem likely that the salaries are not paid wholly for services rendered, but that the excessive payments are a distribution of earnings upon the stock. [37]

Like regulations have been held to be fair interpretations of the Congressional intention. *H. Levine & Bros., Inc., vs. Commissioner, supra.*

Except for one qualifying share, 50 per cent of petitioner's stock was owned by Hayek and the other 50 per cent was either owned by Kennedy as his separate property or by Kennedy and his wife as community property. Since both Hayek and Kennedy were employed by petitioner and devoted all of their time to petitioner's business, it would not make much difference, if any, to petitioner and its stockholders, except taxwise, whether petitioner distributed its earnings as dividends or in the form of compensation. Under such circumstances close scrutiny is invited.

Petitioner has declared or paid no dividends as such since the fiscal year ended June 30, 1938. During that year it paid a dividend of \$5,006 which is 20 per cent of its capital stock. During that year it paid its officers a total compensation of \$15,322.40 and had a net profit after taxes of \$4,860.97. During the next four years petitioner's net profits after taxes increased materially over each preceding year. Notwithstanding these increased profits petitioner did not declare or pay any dividends, as such, but did materially increase the compensation paid its two officers at two different times. The first increase, voted on April 30, 1940, was made retroactive to July 1, 1939, and increased the salary of each officer to \$12,000 per year. This was a total increase over the previous year of \$9,011.30, or about 36 per cent of the capital stock. The second increase, voted

on June 11, 1941, was made retroactive to July 1, 1940, and increased the compensation of each officer by \$5,000 per year. This together with the scrap proceeds amounted to a total increase over the previous year of \$11,678.36, or about 46 per cent of the capital stock. Of course, if the total payments to Hayek and Kennedy were in fact payments purely for services and were reasonable under all the circumstances, they would be deductible under section 23 (a) (1) (A) of the Code in any event. The Christman Company, 8 T.C. . . . , promulgated March 31, 1947.

We do not think that under all the circumstances the bonuses paid to Hayek and Kennedy can be considered in fact payments purely for services. We think that under all the circumstances these payments must be regarded in the nature of dividend distributions on stock and we have so found as an ultimate fact in our findings.

Petitioner in its briefs contends that considerable weight should be given to the testimony of Charles W. Miller, one of the partners of Miller Dial & Nameplate Company. The latter company was the principal competitor of petitioner in the Los Angeles area. During 1942, this competitor paid its two partners total salaries of \$42,000. Miller's testimony can not be given the weight for which petitioner contends for the reason that during the years 1941 and 1942 Miller Dial & Nameplate Company was a partnership and not a corporation. As a partnership it could easily distribute all of its earnings in the form of salaries to its partners without

being questioned by the taxing authorities. That is not true in the case of corporations where consideration must be given to whether the payments are in fact purely for services actually rendered and whether they were reasonable under all the circumstances. Cf. *Woodcliff Silk Mills*, 1 B.T.A. 715.

There is no doubt that both Hayek and Kennedy worked long hours during the taxable years here involved and were very competent men in the line of work in which petitioner was engaged. But only about two months prior to the beginning of the taxable years here involved their regular salaries were substantially increased up to \$12,000 per annum for each officer. This represented an increase of more than 59 per cent over the preceding year. For the reasons previously given and the fact that no dividends as such were declared since June 30, 1938, we think that \$12,000 a year for each officer plus the scrap sales is all that can reasonably be allowed as deductions under section 23 (a)(1)(A), *supra*, for the taxable years here in question. Cf. *Am-Plus Storage Battery Co. v. Commissioner*, 35 Fed. (2d) 167; *A. David Co. v. Grissom*, 64 Fed. (2d) 279; *Crescent Bed Co., Inc., v. Commissioner*, 133 Fed. (2d) 424; and *The Shield Company, Inc.*, 2 T.C. 763. We hold, therefore, that the respondent's determination as to the bonuses was correct. It follows that during the taxable years here involved petitioner is only entitled to deduct under section 23 (a)(1)(A), *supra*, the total amounts of \$24,000 for each year plus the payments from the

scrap sales as reasonable compensation paid its officers Hayek and Kennedy.

We will now consider the third issue as previously stated. The material provisions of section 102, except for the rates of tax, are identical for each of the taxable years ended June 30, 1941 and 1942, and are in the [40] margin.²

The respondent does not contend that petitioner was "formed" for the purpose of avoiding surtax upon shareholders. Neither does he contend that during the taxable years petitioner was "a mere holding or investment company" as that term is used in section 102 (b). It is clear, of course, that petitioner was not a mere holding or investment company and that it was not formed for the inter-

²SEC. 102. SURTAX ON CORPORATIONS IMPROPERLY ACCUMULATING SURPLUS.

(a) Imposition of Tax. There shall be levied, collected, and paid for each taxable year (in addition to other taxes imposed by this chapter) upon the net income of every corporation (other than a personal holding company as defined in section 501 or a foreign personal holding company as defined in Supplement P) if such corporation, however created or organized, is formed or availed of for the purpose of preventing the imposition of the surtax upon its shareholders or the shareholders of any other corporation, through the medium of permitting earnings or profits to accumulate instead of being divided or distributed, a surtax equal to the sum of the following:

* * * *

(b) Prima Facie Evidence. The fact that any corporation is a mere holding or investment com-

dicted purpose. The issue is therefore narrowed to whether petitioner was "availed of for the purpose of preventing the imposition of the surtax upon its shareholders * * * through the medium of permitting earnings or profits to accumulate instead of being divided or distributed * * *."

The respondent determined and he contends that during the taxable years here in question petitioner permitted its earnings or profits "to accumulate beyond the reasonable needs of the business" as that phrase is used in section 102 (c). By virtue of section 102 (c), the accumulation of earnings or profits beyond the reasonable needs is determinative of a purpose to prevent the imposition of the surtax upon the shareholders, unless the petitioner by a clear preponderance of evidence proves to the contrary. See *Whitney Chain & Mfg. Co.*, 3 T.C. 1109, affirmed 149 Fed. (2d) 936.

The determination of whether petitioner during the taxable years in question permitted its earnings or profits "to accumulate beyond the reasonable needs of the business" or whether petitioner was "availed of" for the interdicted or condemned purpose are questions of fact to be determined from all of the evidence. See sections 19.102-2 and

pany shall be prima facie evidence of a purpose to avoid surtax upon shareholders.

(c) *Evidence Determinative of Purpose.* The fact that the earnings or profits of a corporation are permitted to accumulate beyond the reasonable needs of the business shall be determinative by the purpose to avoid surtax upon shareholders unless the corporation by the clear preponderance of the evidence shall prove to the contrary. [41]

19.102-3 of Treasury Regulations 103. See also *Helvering v. National Grocery Co.*, 304 U.S. 282; *Helvering v. Chicago Stock Yards Co.*, 318 U.S. 693; *Cecil B. DeMille Productions, Inc.*, 31 B.T.A. 1161, affirmed 90 Fed. (2d) 12, certiorari denied 302 U.S. 713. [42]

We think petitioner has met its burden of proof. Upon the evidence received at the hearing we have found as ultimate facts that during the taxable years in question petitioner did not permit its earnings or profits to accumulate beyond the reasonable needs of its business and that it was not availed of for the purpose of avoiding surtax upon its shareholders. The evidentiary facts in support of these ultimate findings are set out in considerable detail in our findings and need not be repeated here except in very brief summary form.

After Kennedy's experience upon behalf of petitioner in 1931 of attempting to refinance a second mortgage, petitioner adopted a policy of financing all capital additions from its earnings rather than in part through loans. In this connection Kennedy testified that in 1931 he tried everybody in Los Angeles whom he thought would loan money; that he was unable to find anyone in Los Angeles who would take the mortgage; that he finally was able to find a bank in Chicago who advanced a part (\$6,000) of the funds necessary to refinance the mortgage; that Hayek put up the balance that was necessary; and that

I spent the worst six months, I think, that I ever spent in my life at that time, and we had

to make it up between us or lose the business. It was really terrific. I determined I would never get myself into debt to a bank again.

The statute does not prohibit such a policy as petitioner adopted after its 1931 experience. It is only when the accumulation goes "beyond the reasonable needs of the business" that the statute is apt to apply. See *General Smelting Co.*, 4 T.C. 313, 323. [43]

In the instant proceeding both Hayek and Kennedy testified at considerable length as to certain needs of the business for which petitioner was accumulating its earnings. These may be summarized in minimum amounts as follows:

New building	\$150,000
Moving to new building.....	24,000
New lithographic press.....	38,000
Installation of infra red conveyors.....	12,000
Additional plating facilities.....	15,000
Anodizing license and equipment.....	15,000
Plastic and other equipment.....	25,000
<hr/>	
Total.....	\$279,000

We are convinced from the evidence that the above business needs as testified to by Hayek and Kennedy are all reasonable requirements for the continued successful operations of petitioner's business. As was said in *William C. deMille Productions, Inc.*, 30 B.T.A. 826, "it must be assumed that any business shall have the right to grow." During the taxable years petitioner purchased the Boyle Avenue property at a cost of about \$8,000 as the

intended site for its new building and spent \$19,438.40 for additions to its plant and equipment. For the reasons stated in our findings this site proved not suitable as a site for petitioner's new building and petitioner is now endeavoring to exchange it for a property more adaptable to petitioner's needs. A great many of these necessities as testified to by Hayek and Kennedy cannot be installed until the new building is erected.

In view of all the facts we do not think the accumulations during the taxable years were unreasonable. During the two taxable years here involved petitioner's surplus increased from \$42,183.61 to \$114,185.01, an increase of \$72,001.40. This increase is made up of earnings for 1941 of \$30,232.46; earnings for 1942 of \$41,150.25; and miscellaneous credits to surplus of [44] \$618.69. These earnings for 1941 and 1942, totaling \$71,382.71, are the earnings after deducting Federal taxes already paid of \$67,307.08. The latter amount does not include the deficiencies here in question totaling \$30,098.59. In view of our holding on the issue of the reasonableness of salaries, a substantial portion of these total deficiencies plus interest will have to be paid. After considering all the evidence we think it is apparent that petitioner's accumulations at the end of the taxable year 1942 fell short of being sufficient to meet the reasonable needs of petitioner's business, present and prospective, within the reasonable future.

In his brief the respondent makes reference to

the needs testified to by petitioner's officers in the total minimum amount of \$279,000, and says:

* * * Respondent recognizes that this Court and the appellate courts have held that a corporation may accumulate gains and profits consonant with the needs of the business without being liable for the tax in question, nevertheless, he submits that considering all of the evidence of record the petitioner has failed to justify the accumulation herein involved. With respect to the expenditure of \$150,000 for a new building the Court's attention is directed to the fact that the petitioner gives no consideration at all to the use of credit or to the fact that there would be some realization from the sale of its present plant which was carried out on the books at a value of \$58,000 and in all probability had a market value considerably in excess of this figure. [54]

We do not understand that section 102 of the Internal Revenue Code and the regulations promulgated thereunder prevent a taxpayer corporation from making a reasonable accumulation of its earnings to finance expansion and modernization programs out of its own funds rather than to resort to borrowing for that purpose. *General Smelting Co. supra.* As to whether there would be some realization from the sale of petitioner's present plant, the answer is that of course there would be. The \$58,000 figure mentioned by the respondent (which is cost of \$79,512.41 less depreciation of \$20,783.13)

is a part of petitioner's accumulated surplus of \$111,185.01. If that amount were not carried as an asset, petitioner's surplus would be that much less.

The respondent contends that a strong factor in support of his determination is the fact that petitioner has declared or paid no dividend, as such, since the fiscal year ended June 30, 1938. Our holding on the first issue, however, mitigates considerably the force of this contention. Under the first issue we held that the total amounts paid to petitioner's officers as bonuses during the taxable years were not deductible by petitioner as ordinary and necessary expenses in the form of compensation but were in the nature of dividend distributions on stock.³ We think under all the circumstances these amounts must be treated as dividends. Therefore, it is not correct to consider this proceeding as one in which no dividends were paid.

We, therefore, sustain the petitioner on this issue.

Decision will be entered under Rule 50.

Entered May 29, 1947. [47]

³See section 19.23 (a)-7 of Treasury Regulations 103, which among other things provides: "Thus, in the case of excessive payments by corporations, if such payments correspond or bear a close relationship to stock holdings, and are found to be a distribution of earnings or profits, the excessive payments will be treated as a dividend." [46]

[Title of Tax Court and Cause.]

MOTION TO VACATE AND SET ASIDE THE
MEMORANDUM FINDINGS OF FACT
AND OPINION

Comes now the petitioner, Kennedy Name Plate Company, by Preston D. Orem and C. Earle Memory, its counsel, and moves the Tax Court of the United States to vacate and set aside its decision and memorandum findings of fact and opinion dated May 29, 1947, and in support of said motion states as follows:

1. That the Tax Court of the United States is an agency of the Government of the United States within the meaning of Section 2 of the Administrative Procedure Act (Chapter 324—Public Law 404) and Eugene Black, Judge of the Tax Court of the United States, is a presiding officer of that agency within the meaning of Sections 7 and 8 of the Administrative Procedure Act. The Lincoln Electric Co. vs. Com., Sixth Circuit Court of Appeals—decided June 5, 1947.

2. That on June 12, 1946, a hearing was held in Docket No. 6695 at Los Angeles, California, which hearing was presided over by said Eugene Black, Judge of the Tax Court of the United States. [48]

3. That on June 9, 1947, petitioner, through its counsel, received a copy of the Memorandum Find-

ings of Fact and Opinion in Docket No. 6695 dated May 29, 1947, by United States mail from the said Court.

4. That said Memorandum Findings of Fact and Opinion dated May 29, 1947, was an initial decision of the said Court within the meaning of Section 8 (A) of the Administrative Procedure Act, but was served on petitioner without notice and without giving petitioner a reasonable time to submit its objections and exceptions to said initial decision together with its reasons in support of said objections and exceptions, pursuant to Section 8 (B) of the Administrative Procedure Act.

Wherefore petitioner prays:

(1) That the Memorandum Findings of Fact, heretofore entered herein dated May 29, 1947, be withdrawn.

(2) That petitioner be granted a reasonable time to file its objections and exceptions to the proposed findings of fact and opinion, pursuant to the Administrative Procedure Act.

Dated: June 18, 1947.

/s/ PRESTON D. OREM,

C. EARLE MEMORY, C.P.A.

Counsel for petitioner.

Received and filed June 20, 1947. [49]

[Title of Tax Court and Cause.]

ORDER DENYING MOTION TO VACATE
AND SET ASIDE MEMORANDUM FIND-
INGS OF FACT AND OPINION HERETO-
FORE ENTERED

On May 29, 1947, we entered Memorandum Findings of Fact and Opinion in this proceeding. On June 20, 1947, petitioner filed a motion to vacate and set aside the Memorandum Findings of Fact and Opinion which had been entered on said date. The motion has been carefully read and considered and it is believed that it should be denied.

Ordered that said motion be and it is hereby denied.

/s/ EUGENE BLACK,

Judge.

Dated at Washington, D. C., July 14, 1947.

Served: July 15, 1947. [50]

The Tax Court of the United States
Washington
Docket No. 6695

KENNEDY NAMEPLATE COMPANY,
Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

DECISION

Pursuant to the determination of the Court as set forth in its Memorandum Findings of Fact and

Opinion entered May 29, 1947, the respondent herein filed a proposed recomputation on July 9, 1947, to which petitioner filed its acquiescence July 29, 1947, now, therefore, it is

Ordered and Decided, that there are deficiencies in income tax for the taxable years ended June 30, 1941 and June 30, 1942 in the respective amounts of \$2,083.19 and \$1,413.68; there are deficiencies in declared value excess-profits tax for the taxable years ended June 30, 1941 and June 30, 1942 in the respective amounts of \$1,320.01 and \$1,320.00; and there are deficiencies in excess profits tax for the taxable years ended June 30, 1941 and June 30, 1942 in the respective amounts of \$2,023.31 and \$4,119.75.

/s/ EUGENE BLACK,

Judge.

Entered: July 30, 1947.

Served: July 30, 1947. [51]

In the United States Court of Appeals

For the Ninth Circuit

Tax Court Docket No. 6695

KENNEDY NAME PLATE COMPANY,

Petitioner.

vs.

COMMISSIONER OF INTERNAL REVENUE.

Respondent.

PETITION FOR REVIEW

Kennedy Name Plate Company, the petitioner herein, by Preston D. Orem, counsel, hereby files

its petition for a review by the United States Court of Appeals for the Ninth Circuit of the decision by The Tax Court of the United States entered on July 30, 1947, under Rule 50 of said Tax Court, subsequent to the entry of Memorandum Findings of Fact and Opinion entered May 29, 1947, determining deficiencies in the petitioner's income tax for the taxable years ended June 30, 1941 and June 30, 1942 in the respective amounts of \$2,083.19 and \$1,413.68; deficiencies in declared value excess-profits tax for the taxable years ended June 30, 1941 and June 30, 1942 in the respective amounts of \$1,320.01 and \$1,320.00; and deficiencies in excess profits tax for the taxable years ended June 30, 1941 and June 30, 1942 in the respective amounts of \$2,023.31 and \$4,119.75.

I.

The petitioner, Kennedy Name Plate Company, is a corporation duly organized and existing under and by virtue of the laws of the State of California, with its principal office in Los Angeles, [52] California.

Petitioner's income tax, declared value excess-profits tax and excess profits tax returns for the taxable years ended June 30, 1941, and June 30, 1942, in respect of which the deficiencies arise, were filed with the Collector of Internal Revenue for the Sixth California District in Los Angeles, California, which is located within the Circuit of the United States Court of Appeals for the Ninth Circuit.

II.

Nature of the Controversy

The controversy involves the proper determination of the petitioner's liability for federal income taxes, declared value excess-profits taxes, and excess profits taxes for the taxable years ended June 30, 1941, and June 30, 1942.

In its income and excess profits tax returns for the years ended June 30, 1941, and June 30, 1942, petitioner deducted under Section 23(a)(1)(A) of the Internal Revenue Code as "a reasonable allowance for salaries or other compensation for personal services actually rendered." All of the amounts paid to Joseph W. Hayek, president and director of petitioner, and William James Kennedy, secretary-treasurer and director of petitioner, for the said two taxable years, as follows:

	Taxable Year ended June 30, 1941	Taxable Year ended June 30, 1942
Joseph W. Hayek:		
Salary	\$12,000.00	\$12,000.00
Bonus	5,000.00	5,000.00
Scrap proceeds	936.58	858.18
Total	\$17,936.58	\$17,858.18
William James Kennedy:		
Salary	\$12,000.00	\$12,000.00
Bonus	5,000.00	5,000.00
Scrap proceeds	936.58	858.18
Total	\$17,936.58	\$17,858.18
Total—Both Officers	\$35,873.16	\$35,716.36

The respondent allowed only the salaries above given (\$12,000.00 to each officer for each year) as a deduction under the Internal Revenue Code section previously mentioned. The Tax Court has allowed as a deduction the salaries and scrap proceeds and has disallowed as a deduction the bonuses (\$5,000.00 to each officer for each year).

The disallowance of the bonuses to the two officers is the only item in issue, being wholly responsible for the determination of the deficiencies. as afore-said, by The Tax Court of the United States.

III.

Petitioner, being aggrieved by the findings of fact and conclusions of law contained in the said findings and opinion of the Court, and by its decision entered pursuant thereto, desires to obtain a review thereof by the United States Court of Appeals for the Ninth Circuit.

IV.

Assignments of Error

The petitioner assigns as error the following acts and omissions of The Tax Court of the United States:

(1) The failure to allow as a deduction under section 23 (a)(1)(A) Internal Revenue Code, as reasonable compensation for services rendered by its two officers any amount in excess of the regular salaries paid each year in the total amount of \$24,000.00 plus proceeds from the scrap sales.

(2) The holding that the payment of the bonuses

to the two officers in the total amount of \$10,000.00 for each year were in the nature of dividend distributions on stock and not deductible by petitioner as ordinary and necessary expenses under section 23 (a)(1)(A) of the Internal Revenue Code.

(3) The finding of deficiencies for the taxable years ended June 30, 1941 [54] and June 30, 1942, in lieu of a determination that there were no income taxes, declared value excess-profits taxes and excess profits taxes due from the petitioner for the two years in controversy.

/s/ PRESTON D. OREM,
Counsel for Petitioner.

State of California,
County of Los Angeles—ss.

Preston D. Orem, being first duly sworn, says that he is counsel of record in the above-named cause; that as such counsel he is authorized to verify the foregoing petition for review; that he has read the said petition and is familiar with the statements contained therein; and that the statements made are true to the best of his knowledge, information and belief.

/s/ PRESTON D. OREM.

Subscribed and sworn to before me this 23rd day of October, 1947.

[Seal] ELSIE HERZBERG,
Notary Public, County of Los Angeles, State of
California.

My commission expires Feb. 7, 1950.

Received and filed Oct. 27, 1947. [55]

[Title of Court and Cause.]

NOTICE OF FILING PETITION
FOR REVIEW

To Charles Oliphant, Chief Counsel, Bureau of
Internal Revenue, Washington, D. C.:

You are hereby notified that the petitioner on the 27th day of October, 1947, filed with the Clerk of The Tax Court of the United States at Washington, D. C., a petition for review by the United States Court of Appeals for the Ninth Circuit of the decision of The Tax Court of the United States heretofore rendered in the above-entitled cause. A copy of the petition for review as filed is hereto attached and served upon you.

Dated at Los Angeles, California, this 27th day of October, 1947.

/s/ PRESTON D. OREM,
Counsel for Petitioner.

Personal service of the foregoing notice, together with a copy of the petition for review mentioned therein, is hereby acknowledged this 27th day of October, 1947.

CHARLES OLIPHANT,
Chief Counsel, Bureau of Internal Revenue,
Counsel for Respondent.

Received and filed Nov. 3, 1947.

The Tax Court of the United States

Docket No. 6695

KENNEDY NAME PLATE COMPANY,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

EXCERPTS FROM TRANSCRIPT
OF HEARING

At Los Angeles, California, June 12, 1946

(Oral Testimony Included in Petitioner's
Designation on Appeal)

Filed July 1, 1946.

(Met pursuant to notice.)

Before: Hon. Eugene Black,
Judge.

Appearances:

Preston D. Orem, Esq., 416 West Eighth Street,
Los Angeles, California, appearing on behalf of
Kennedy Nameplate Company, Petitioner.

E. A. Tonjes, Esq., (Honorable J. P. Wenchel,
Chief Counsel, Bureau of Internal Revenue), ap-
pearing on behalf of the Commissioner of Internal
Revenue.

Proceedings

The Clerk: 6695, Kennedy Nameplate Company.

The Court: Note the appearances for the Petitioner and Respondent in this case.

Mr. Orem: Appearing for the Petitioner is Preston D. Orem, Esquire, and C. Earle Memory, C. P. A.

Mr. Tonjes: E. A. Tonjes for the Respondent.

The Court: Very well. Mr. Orem, you may state the issues in this case.

Opening Statement on Behalf of the Petitioner
(By Mr. Orem)

Mr. Orem: If your Honor please, this case involves two issues, the reasonableness of the compensation of two officers of the Petitioner in the years ended June 30, 1941 and June 30, 1942, and for those same years Section 102, involving surtax on corporation's allegedly accumulating surplus beyond the needs of the business, instead of declaring dividends.

Those are the two issues. This Petitioner is not a "war baby". It and its predecessors have been continuously in existence since the year 1917, when Mr. Joseph Hayek, who was president of the Petitioner, former the Hayek Nameplate Company in Minneapolis, Minnesota.

In 1921 Mr. James W. Kennedy, who is secretary and treasurer of the Petitioner, purchased the assets of that [60] original business, of which Mr. Hayek was principal stockholder.

Mr. Kennedy then immediately moved the business to Los Angeles. He formed a partnership

with his uncle here, which lasted a long time, then Mr. Hayek came out here and bought out Mr. Kennedy's uncle and became an equal partner with Mr. Kennedy in the Kennedy Nameplate Company, then a partnership, each owning 50 per cent.

In August 1923 the assets of the corporation were acquired by a new California corporation, the Kennedy Nameplate Company, in exchange for \$25,000.00 in stock of the new corporation. By the way, there have been no issues since that original initial one, and that stands unchanged.

Mr. Hayek acquired 50 per cent of the stock and became president and production manager of the company and has so continued to the present time. Mr. Kennedy acquired 50 per cent of the stock and became secretary and treasurer and in charge of all departments except production and has so continued to the present time.

The words "Nameplate Company" are to some extent a misnomer, because the business of the corporation includes a great many items which cannot be termed nameplates.

The salaries drawn by the officers, Messrs. Hayek and Kennedy, up to the year ending in 1940 were very moderate. The salaries for the fiscal years ended in 1937, 38 and 39 were [61] \$7500.00 each, and for 1940 \$12,000.00 each. These later salaries were continued for the years 1941 and 1942, but in these later years the two officers also drew a bonus of \$5,000.00 each for each year, which have been disallowed by the Commissioner as exceeding

a reasonable allowance for services rendered under section 23 of the Code.

The Commission has also added to income for the year 1941 the sum of \$1,873.16. That was from proceeds of the sale of scrap. They had a large accumulation of scrap in the pile. That pile of scrap was sold and the proceeds were retained by the new officers, in the amount of \$936.58 each, and reported as income in their returns but not in the tax return of this company.

For the period ending June 30, 1942, the sum of \$1,716.36 was realized from the sale of the scrap and the proceeds were retained by the two officers, in the amount of \$858.18 each. These sales of scrap were not recorded upon the Petitioner's books, but were picked up on the individual tax returns of the two officers and their respective wives as sales of scrap.

And the Commissioner has also proposed a surtax under the provisions of Section 102, as previously stated, and the foregoing are the issues in the case.

Petitioner will, in the course of its testimony, offer a showing of the background and experience of officers [62] of the company, their services to the Petitioner, duties, the hours worked, standing in the industry, the fact that they have devised new products, new methods of manufacture, techniques, et cetera.

Petitioner will also offer the testimony of expert witnesses capable of forming an opinion, opinions

with respect to the reasonableness of the compensation of the two officers.

Petitioner's case under Section 102 will require detailed testimony by those officers in which we will show that it was necessary for the corporation to retain all of its surplus as working capital for the reasonable future needs of the business, such as additions to its plant, machinery and equipment, reserves for losses from reconversion, replacements, et cetera.

I think that is a brief statement of the case for Petitioner.

The Court: Very well. Mr. Tonjes, do you have any statement?

Opening Statement on Behalf of the Respondent
(By Mr. Tonjes)

Mr. Tonjes: I do not think I need to make a lengthy statement, your Honor. The issues are clear. The Respondent contends that the compensation of officers allowed by him in the notice of deficiency were reasonable for the services [63] rendered by those officers, and on the question with regard to the imposition of the tax under Section 102 Respondent believes the evidence will show that the accumulation of earnings or profits far exceed the reasonable needs of the business, taking into consideration those things which should reasonably be anticipated.

The Court: Very well. We are ready to receive the evidence now in the case. [64]

Whereupon,

WILLIAM JAMES KENNEDY

called as a witness for and on behalf of the Petitioner, having been first duly sworn, was examined and testified as follows:

Direct Examination

By Mr. Orem:

Q. I show you here, Mr. Kennedy—state your full name, please.

A. William James Kennedy.

Q. What is your position with the Kennedy Nameplate Company?

A. Secretary and treasurer.

Q. Did you hold office during the years 1940, 1941 and 1942?

A. I did.

Q. I show you what purports to be the original minutes of the company at a meeting held April 30, 1940, containing the signatures of the directors and officers. Can you identify that document?

A. Yes, I can.

Q. Is that a true and correct copy of the minutes of that date?

A. Yes. [65]

Q. I show you what purports to be a copy of the minutes of a regular meeting of the board of directors of June 11, 1941. Is that a true and correct copy of the minutes for that date?

A. It is.

Mr. Orem: These are offered by the Petitioner as exhibits.

Mr. Tonjes: There is no objection.

(Testimony of William James Kennedy.)

The Court: They will be received in evidence as Petitioner's Exhibits 7 and 8.

(The minutes of the meeting referred to were marked and received in evidence as Petitioner's Exhibits Nos. 7 and 8.)

Q. (By Mr. Orem): Now, you are familiar, are you not, with the by-laws of the Kennedy Nameplate Company?

A. To a considerable extent, yes.

Q. And they were first adopted by the company, were they not, in 1923, when it was incorporated?

A. They were.

Q. Have they ever been amended since?

A. Never.

Q. Will you examine this document and see if those are true and correct copies of certain excerpts from the by-laws?

A. To the best of my knowledge and belief, [66] it is.

Q. I will read this Article 5, Section 2, "Powers of Directors requiring fixing compensation of officers, agents and employees of the corporation and requiring from them security for faithful service." Is that the only provision in the by-laws relating to the fixing of the compensation of officers?

A. To my knowledge. That is the only part that I know of.

Q. I will read Article 6, on the duties of directors: "To declare dividends out of the surplus profits when such profits shall, in the opinion

(Testimony of William James Kennedy.)

of the directors, warrant the same, to accumulate profits and reinvest them in such manner as the directors may deem proper." Is that, to your knowledge——

A. That is to my knowledge.

Mr. Orem: I offer that as an exhibit for the Petitioner.

Mr. Tonjes: No objection.

The Court: Petitioner's Exhibit No. 9 is received.

(The excerpts from by-laws referred to were marked and received in evidence as Petitioner's Exhibit 9.)

Q. (By Mr. Orem): Mr. Kennedy, how long have you continuously held the office of secretary and treasurer of the Kennedy Name plate Company? [67]

A. About 23, since August 1923.

Q. That was at the time the company was formed? A. That is correct.

Q. Have you also been continuously a director of the company from 1923 to date? A. I have.

Q. When was the Kennedy Nameplate Company incorporated under the laws of what state?

A. The State of California, August 19, 1923.

Q. Then, from the time 1923 down to the present date did you devote any part of your time to any business other than the Kennedy Nameplate Company? A. Never.

Q. Now, will you state the extent of your tech-

(Testimony of William James Kennedy.)

nical education prior to entering into business life?

A. Well, my technical education was probably not particularly technical in the sense that the phrase implies. I went to business college for three years after I graduated from high school, and completed two courses with the International Correspondence School and took one year tuition in Spanish and commerce and other miscellaneous studies.

Q. Did you engage in any post graduate work at the Southern California University?

A. I did.

Q. How many years? [68]

A. About six years.

Q. What did you study there?

A. Advertising and selling, business management, various things connected with my particular duties.

Q. During what years was that, approximately?

A. That was from on or about 1926 up to 1934 or 1935.

Q. Were you a director of any college at any time?

A. I was a director of University College, which was the extension division of S. C., for two years.

Q. What years?

A. That, I believe, was 1931 to 1933.

Q. Prior to your connection with the Kennedy Nameplate Company, what position did you hold?

A. I was a—well, do you mean just immediately prior?

(Testimony of William James Kennedy.)

Q. Well, starting right from the beginning—I will see if I can save time by asking you whether you were ever connected with Marshall Field and Company? A. I was.

Q. Was that 1912 to 1914? A. Correct.

Q. And from 1914 to 1915 were you assistant to the vice-president of Wilson & Company?

A. I was, then known as Sulzberger & Sons.

Q. And during the years 1915 and 1917 were you an executive of Stewart Mfg. Co. of Chicago?

A. I was an executive for part of the time.

Q. You were employed with them during those years how?

A. Particularly with the Stewart Manufacturing Division of Stewart-Warner.

Q. Did you become connected in 1917 with the National Products Company of New York City?

A. Yes, sir, I was.

Q. What was your position with them?

A. I was office manager of the New York office and in charge of the agency operated for South America and all the duties of the office.

Q. Were you purchasing agent at any time?

A. Subsequently purchasing agents worked under me. I did purchasing agent work in New York.

Q. Did you have anything to do with sales of by-products?

A. Yes, I took complete charge of the sales of all by-products.

Q. Everything for South America?

A. Yes.

(Testimony of William James Kennedy.)

Q. What was the name of the company down there?

A. The name of the company, we operated two South American companies, one was known as Compania Central de Productos, and the other company Compania Internacional de Productos.

Q. In what places did they operate? [70]

A. Paraguay, Argentine, part of Brazil and part of Uruguay.

Q. What was your position down there?

A. My position down there was one of managing the concern.

Q. You were an executive then?

A. I was executive of the South American companies.

Q. From at least 1916 on you were an executive of those various companies.

A. Yes. In South America I had more of a manager position than I had in New York.

Q. You were, as a matter of fact, managing the business?

A. I managed several departments. I had charge of all of their sales, which included their almacens, then I did purchasing in connection with the purchasing office in New York for the companies down there, and sales of all by-products, which meant the bones, hides, import and export. I also had charge of all relations with the government.

Q. And that was down to the end of 1921?

(Testimony of William James Kennedy.)

A. I resigned about the 1st of March, I think, of 1921.

Q. Did you then engage in the nameplate business?

A. I came to the United States, returned to the United States in March, 1921, and got into the nameplate business about June of that same year.

Q. At that time you purchased, did you not, the Hayek Nameplate Company? [71]

A. I did.

Q. Hayek Nameplate and Novelty Company of Minneapolis.

A. My uncle and myself purchased that company.

Q. You became acquainted with Mr. Joseph Hayek at that time, did you not? A. I did.

Q. He was principal owner of that company?

A. As far as I knew he was.

Q. Did you move that business to Los Angeles?

A. We did.

Q. Immediately after you purchased?

A. As soon as we could load it up and put it on a train.

Q. From 1921 to 1923 you operated here as the Kennedy Nameplate Company, a partnership, did you not?

A. Yes, sir, a fictitious trade name.

Q. Then Mr. Joseph Hayek came out and purchased your uncle's half interest in the firm?

A. Yes, sir, and this uncle of mine was a wealthy

(Testimony of William James Kennedy.)

man and rather old and he didn't want it particularly and was willing to sell out because the business was not doing so very good at that time.

Q. Immediately before you went in the nameplate business, which was in June 1921, during the last full year that you were employed then, which would be the year 1920, what were [72] your annual earnings?

A. From the company around \$8000.00 a year.

Q. Did you have other allowances that increased this?

A. I had a traveling allowance of various kinds, and then, of course, they took care of my living expenses for several months of the year. I traveled a great deal.

Q. At the time you purchased the Hayek Nameplate and Novelty Company in Minneapolis, did you have some salary offers from other companies about that time? A. Well, previously.

Q. From what company did you have those salary offers?

A. I was offered a salary of \$10,000.00 a year from a Japanese firm in Japan, then I had an offer from a Brazilian steamship company, also the Johnson Steamship Company, a salary of \$25,000.00 a year there.

Q. Did you also have an offer from a canning company in Indiana?

A. In Indiana they wanted me to take over a factory making pasta for Italians, that is tomato sauce.

(Testimony of William James Kennedy.)

Q. Just what were you to get paid for that work?

A. They wanted me to take over the factory, and talking about this job in South America for the steamship company there in Brazil, I just didn't like South America or I would have taken it.

Q. Now, coming down to the years ended June 30, 1941, [73] and June 30, 1942, which are the years in question here, state what your duties were with the Kennedy Nameplate Company; you were secretary, treasurer and director. Just what were your general duties?

A. I have complete charge of all sales, advertising, all of the business, all the various parts of the business not connected with production.

Q. Did you have anything to do with the pricing of the goods?

A. Oh, yes, I figured the prices.

Q. How about the employment of technical personnel?

A. I employed some technical personnel and Mr. Hayek employed others.

Q. How about collections, did you handle collections? A. Oh, yes.

Q. And purchases?

A. And purchases under my supervision by Mr. Koelling.

Q. Did you also purchase?

A. Ch, yes, I did a great part of the work, because I did most of the contact work with him.

Q. Was it part of your duties to keep in con-

(Testimony of William James Kennedy.)

stant touch with new technological developments and processes? A. It was.

Q. In other words, you might sum it up by saying you ran the business entirely other than actual production that [74] Mr. Hayek was in charge of?

A. Yes, I believe that would be pretty near right.

Q. In other words, it was a two-man affair?

A. Right.

Q. During the years ended June 30, 1941 and June 30, 1942, what were the approximate hours per day that you worked for the Kennedy Nameplate Company and how many days a week?

A. I worked five and a half days a week, that is, the business was open five and a half days a week, I believe that was when the Wage and Hour law came into effect at that time, which I think set the hours.

Q. Well, were you confined to those hours?

A. Oh, no.

Q. What hours did you personally work?

A. Well, I guess that I worked most of the time, because even my spare time was largely devoted to the business.

Q. What were the approximate hours per week?

A. I would say eight to ten hours a day.

Q. That is during the years 1941 and 1942?

A. Yes, I would think so.

Q. And does that include Saturday?

A. Yes, I very frequently worked on Saturdays, my Saturdays were frequently devoted to the

(Testimony of William James Kennedy.)

Q. Can you tell just generally, without divulging any trade secrets, just generally, what was the nature of those processes?

A. Well, they are better formulas used in etching, different processes for preparing the metal for etching, and different methods of etching out the metal so prepared, and different methods of finishing.

Q. Then later on in the years 1935 and 1939, did you enlarge the photo engraving department?

A. Yes, we did.

Q. Did you manufacture decalcomania transfers?

A. We did.

Q. When did you first commence the manufacture of such transfers, approximately?

A. I believe about 1936 or '37, around in there. I don't have that in my mind.

Q. And that also required purchasing new equipment, did it not?

A. Right. It is an entirely different product.

Q. Do you make plastic nameplates?

A. We do.

Q. When did you start such manufacture?

A. We commenced to manufacture plastic material nameplates during the war when metals became scarce.

Q. In other words, because of the war demand for metals, you had to substitute plastic?

A. That is correct.

Q. You used fibre, did you not?

A. We used fibre and different plastics.

(Testimony of William James Kennedy.)

Q. That made a very great change in the processes, did it not?

A. That just about turned the nameplate business upside down in 30 days.

Q. Has your work in plastics ever been recognized by any authorities?

A. Yes. We devised, I believe, a plastic which was satisfactory and found to be the most suitable nameplate plastic that was devised. In fact, it is used by other companies.

Q. Did you get recognition of that by the government or otherwise?

A. We got a number of citations from some of the aircraft companies. We had a lot of trouble in the trade with [79] all those citations, so we didn't really take them too seriously when they gave them out, although we have them in our office.

Q. Did you manufacture scales, dials and instruction and designation plates? A. We did.

Q. When did you start such manufacture?

A. There always was a certain amount of scales and dials tied in with the nameplates. The aircraft business was one of the main developments in such.

Q. In other words, that type of business was enormously increased, was it not?

A. That is right.

Q. And the regular nameplate business was very greatly decreased?

A. I have some samples of our scales——

Mr. Tonjes: I might suggest, your Honor, I

(Testimony of William James Kennedy.)

haven't made any objection but I might suggest that counsel is going pretty far in leading the witness, and I would suggest he ask questions instead of making a statement and having the witness say yes or no.

Mr. Orem: It is leading, but just to save time, that is the only purpose for some of these things.

Mr. Tonjes: Yes, but it is going a little far, counsel, the only objection I have. [80]

Q. (By Mr. Orem): Have you a scale of your manufacture with you? A. I have.

Q. Can you show that scale to us?

A. I can. We will take that first one there, then.

Mr. Orem: I will state the purpose of this witness is to show the Court just what kind of business the Petitioners are engaged in, which is far from nameplates. I mean that covers only a part of it.

The Witness: This is a scale which combines metal and plastics together. It is a bomb chart used on the B-24. This works like a slide rule. It has a place here to show how the different bombs are to be located in the regular stations. For example, there is a 500 pound bomb, shows the situation over here, and shows the purpose of that bomb here, the A.N. number, that is the Army-Navy number, the actual weight of the bomb, and on this side it shows the angle at which that bomb has to be released. The plastic inside is vinylite or vinyl chloride, the outside pieces are of acetate. This scale is also used by Ford.

(Testimony of William James Kennedy.)

Q. When did you first begin to make such scales, Mr. Kennedy?

A. Well, the development of the aircraft industry continued all along, 1941 and right straight through, but [81] actually this object here or this scale was made about 1943.

This scale, these scales here, this type here, this was made for airplane plants. The device was made about 1940 or 1941. I couldn't give you the date of any one of these devices we manufactured because there is no way I can recognize by looking at the job when it was made, but these were all made during the period under consideration.

Q. How does your volume for the years ended June 30, 1941, and June 30, 1942, the manufacture of such scales compare with the prior volume?

A. Well, I don't believe that there was any manufacture of scales in volume prior to that period. The scales we made would be a dial for a jeweler or something of that sort. The developments in that period made the scale business.

Q. Do those scales require more precision to make than a scale for a jeweler?

A. Well, no question about that. If they are not precise, they send them back to you.

Q. How often were the government inspectors there?

A. They sent inspectors out to the plant to inspect the stuff we had made and we had to get the people trained to make them, and the inspector comes to the plant with a blue print and he checks

(Testimony of William James Kennedy.)

the measurements from the copy, and then he approves, and then it may be shipped. Sometimes where the product goes to a distant place they may reserve the right [82] to inspect at destination.

Q. Just how close do these measurements have to approximate the constructed measurements?

A. Well, I guess at the average, there is a little decimal in there, at all times has to be plus or minus 5/1000ths.

Q. You mean only 5000 to the inch?

A. Plus or minus 5/1000ths. That is 5/1000ths of an inch.

Q. If they were much more than that or much less than that, what would happen?

A. They would reject them.

Q. What would happen then? Could you cure that?

A. No, make it over again. There were some dials down to 2/1000ths of an inch, and that is pretty fine.

Q. Now, what about dials? Have you a type of the dial with you that you manufacture?

A. Yes, this is a dial. There are also some plastic parts here.

Q. What is the purpose of that particular dial that you have in your hand there?

A. I couldn't tell you, because I don't know. To my mind it is just a dial, has nothing on it at all to show what it was used for. I don't remember what it was used for.

(Testimony of William James Kennedy.)

Q. Would it be a part of an airplane equipment? [83]

A. It will have some function on an airplane. I don't know what particular part it is.

Q. What was most of your dial business during the years ended June 30, 1941, and June 30, 1942?

A. Most of them were dials for Douglas, Consolidated, North American, Northrop, all the large aircraft companies, Vultee.

Q. And what were they to be used for?

A. Mostly instrument parts on planes.

Q. Did you make those dials during the years 1941 and 1942?

A. Only in small quantities. Some of them were what they called X.B. models, experimental models.

Q. Reference has been made to instruction plates on aircraft. What is that?

A. Well, an instruction plate, one example would be a plate which tells someone to do something. This is an instruction plate which says "Do not open this magazine in case of fire." They may be, they could very well be set on several parts of an airplane, on the places where a fellow must not sit, they might say "Don't sit here," or might say, "Oil here" or might give some information.

Q. What is a designation plate?

A. A designation plate would be a plate which indicated that this was a certain part or number of instrument. [84] It might be too—there is a sort of plate in general use also which tells something about what that particular button will do. It may

(Testimony of William James Kennedy.)

be, in one instance, one example is what they call the bomb jettison. Supposedly when pilots return from a flight and they have not used all the bombs, they are supposed to jettison them before they return to their base. We might make a plate that will indicate to the pilot that if he pulled that plate up and pushes that certain switch he will jettison all his bombs at one time. That would be a designation plate.

It may be like a plate that identifies the signal to the crew to abandon ship. We would make that as a cover so it would not be hit accidentally. That plate in case of accident will prevent that, and the pilot has to reach his hand underneath that, and that would be a designation plate, and designed to tell somebody about something that would not be visible from the general appearance.

Q. Was that business increased in 1941 and 1942 over prior years?

A. We had an amazing increase.

Q. Was there any change in the materials used?

A. Sure. We switched from mostly brass to mostly aluminum and dural and all types of metals.

Q. Did that make a change necessary in your manufacturing processes? [85]

A. Yes, it practically deviated us from where we had been into an entirely new field.

Q. Now, did you manufacture luminous, fluorescent and phosphorescent nameplates?

A. We do.

Q. When did you begin such manufacture?

(Testimony of William James Kennedy.)

A. Well, originally we brought the material out about 1931 or 1932, but that actually was mostly experimental in those days. We made the products up to be introduced, but very little interest at that time. The main interest in these luminous or what we call fluorescent lights became evident when some pilots were allergic to radium.

Q. When did you begin to make those plates in any quantity, that is, any appreciable quantity?

A. About 1941.

Q. For what purpose were they made, in general?

A. So a pilot could read a plate at night without having illumination.

Q. Now, in making those items, tell us what materials you used?

A. We used some radium, some radium activity of our own that went on dials in places where they were not permanently lighted. Then we had and used a phosphorescent of our own requiring black light for activation. We also used a phosphorescent material that would just soak in light [86] and give off light for about eight hours after the light was turned off.

Q. Was any extensive experiments required in the perfecting of that?

A. Yes, we perfected this type and we introduced it ourselves personally without any response until they found some pilots who were allergic to the test amounts of radium, and began to put it in most of the planes.

(Testimony of William James Kennedy.)

Q. How did you introduce this in the markets?

A. I took a black light and a number of nameplates we had made up experimentally and I visited the airplane companies personally and turned the black light on and then showed them how they acted.

Q. What time was that?

A. Say 1939, 1940 and the early part of 1941.

Q. When did you begin to get orders as a result of those visits?

A. The first ones they had CVA Field down at San Diego, Consolidated Vultee Aircraft, we commenced to get orders for small numbers of them, and finally the government commenced to specify large numbers of those.

Q. Did you have any problems in your plant with regard to manufacture of those?

A. Yes, we did. Handling it in quantity, some of the materials were very offensive to people working with them, [87] they would cause sickness or cause discomfort. We had to devise various ways of working with the material. We had to find means of doing that work under lead or under glass so the employees would not touch or handle the material in any way that they would get their hands on it, and even so the odor got very confusing.

Q. Now, generally speaking, was there any change in the matter of accuracy required or care in manufacture in 1941 and 1942 over prior years?

A. Oh, yes. The average commercial product, if it was visually correct, that was satisfactory, if it

(Testimony of William James Kennedy.)

looked all right it was acceptable, the average commercial product.

Q. Were your sales prior to 1941 mostly commercial products?

A. I would say before 1941 85 to 90 per cent of the customers were commercial firms, and when I say commercial firms I mean various firms that happened merely to need the job.

Q. Were those jobs, did they have any inspectors?

A. A number of firms had receiving departments, but they did not have inspection of the type that existed during the war.

Q. In 1941 and 1942, when you were doing the government work, was there any difference in execution?

A. Yes, the requirements became stricter on that.

Q. Was it any more difficult to make the products that you manufactured in 1941 and 1942 than those that you had produced previously?

A. Absolutely.

Q. And you had to devise these various processes of manufacture of these?

A. I had to confer sometimes on it myself, mostly Mr. Hayek was handling it, but sometimes he wanted me, too. Both of us simultaneously. We discussed these various matters and after we figured out some way of working it we would have the job of figuring out how to do it.

Q. In connection with the use of radium, were there any special problems?

(Testimony of William James Kennedy.)

A. The use of radium brought in the problem, of course, of the human relationship to radium, which is not very good. It also required that you set up in connection with that department numerous restrictions which are rather rigorous, must be kept under lead, all the supplies must be kept under lead, in order to prevent harmful radiations from attacking any human being. [89]

Q. Did the Kennedy Nameplate Company have a system of bonuses for its employees?

A. It had.

Q. When did you first start paying bonuses to your employees? A. About 1931.

Q. What did they consist of, these bonuses?

A. Originally they consisted of \$5.00 for the men in the minor employees, and \$10.00 for those men who had a little bit more authority. That was a monthly business.

Q. Then it was a one to four weeks pay bonus later on? A. That is correct.

Q. You paid that during 1921 and 1922?

A. That is correct.

Q. And you paid those bonuses during 1941 and 1942 to [90] your regular employees? A. Yes.

Q. I show you the Petitioner's Exhibit No. 7, being the minutes of the meeting of April 30, 1940, which you already testified were the full minutes of the directors for that date. Were the salaries of yourself and Mr. Hayek fixed at that meeting?

A. They were.

(Testimony of William James Kennedy.)

Q. And what amount was fixed as being your salary? A. \$12,000.00 per year.

Q. When did that start?

A. Retroactive to July 1, 1939.

Q. Then I will show you the minutes of the Board of Directors of June 11, 1941, Petitioner's Exhibit No. 8. Was any action taken with regard to your compensation at that meeting?

A. It was.

Q. A bonus of \$5,000.00 was voted to yourself, also a similar bonus to Mr. Joseph Hayek?

A. It was.

Q. Now, \$12,000.00 plus \$5,000.00 makes a total of \$17,000.00 compensation for the year ended June 30, 1942, did it not? A. It does.

Q. Did you receive that amount in cash, that \$17,000.00 [91] A. I did.

Q. Did Mr. Hayek, if you know, receive a similar amount of \$17,000.00 in cash, in the year ended June 30, 1941? A. He did.

Q. What was your compensation for the next year, the year ended June 30, 1942?

A. As far as I recall, it was the same.

Q. Well, referring to the exhibit of Petitioner, the Exhibit No. 2, you note the figure for the year ended June 30, 1942, \$34,000.00. To the best of your knowledge is that correct?

A. It is correct.

Q. Would that be \$17,000.00 for each officer for the year ended June 30, 1942?

A. That would be.

(Testimony of William James Kennedy.)

Q. Now looking at Exhibit 2, you will note total compensation to yourself and Mr. Hayek, which you have already testified was \$50,506.00 for the year 1936 and \$65,426.00, being \$3,200.00 apiece for 1937, being \$7,500.00 each for 1938, and in 1940 a little over \$24,000.00, being a little more than \$12,000.00 each, is that, to the best of your knowledge, what you actually received in those years?

A. That is.

Q. Now how long have you known Mr. Joseph Hayek? A. A little over 25 years. [92]

Q. You first met him, I believe, you testified, in Minneapolis. A. Minneapolis.

Q. When he was president and principal stockholder of the Hayek Nameplate Company.

A. That is correct.

Q. Have you been continuously associated with him since in the nameplate business?

A. I have been.

Q. And his position, I believe you testified, was president, director, and in full charge of production? A. Correct.

Q. During these years have you had an opportunity to observe the capabilities of Mr. Hayek, and form an opinion as to his value to the company?

A. I certainly have.

Q. Does Mr. Hayek devote his entire time to the company, during the period from 1923 to the present time? A. He did.

Q. To your knowledge, did he have any outside business activities? A. Nothing.

(Testimony of William James Kennedy.)

Q. In your opinion, did Mr. Hayek receive adequate compensation for his time and services with the company during the years 1936 to 1940, that is the 15 years immediately [93] preceding the two years in issue?

A. No, he didn't, because in those days Mr. Hayek and I were in partnership, and he was paid inadequately for the work he did, because that was the way it had to be.

Q. During those years I just mentioned, 1936 to 1940?

A. No, we were like everybody else, just doing our level best to keep enough working capital to keep going, not to pay more than what we thought we were worth.

Q. In spite of the fact that you kept those salaries low, the exhibit shows you had to loan money to the company, does it not, as you previously testified?

A. Yes, sir, we did.

Q. Pardon me, Mr. Memory previously so testified.

Q. In fixing the compensation of Mr. Hayek and yourself at \$17,000.00, during the years 1941 and 1942, did you as a director and the other directors, consider the amount of compensation that you received in prior years, in fixing that amount?

A. To some extent, yes, we did.

Q. Then that was inadequate compensation you testified to in prior years.

Mr. Tonjes: Don't lead the witness.

(Testimony of William James Kennedy.)

The Court: Yes, be careful about leading the witness.

Mr. Orem: Well, never mind, strike that. [94]

Q. (By Mr. Orem): In your opinion, based upon your long business experience with Mr. Hayek and his services to the company rendered during the years ended June 30, 1941, what would you consider the reasonable value of his full time services to the company to be worth that year?

A. That would be rather difficult to answer. It is hard to say, because the company could not have existed without his attention to the factory. We could hardly pay him for what he did, I don't believe.

Q. Well, if it was a question of bargaining, in other words, if you had bargained with him as to what you were going to pay for his services during that year, what do you think would have been reasonable?

A. Well, men of his ability were very scarce, and it would be hard to say what you could have done during that time. You would have made the best deal that you could, and he very fortunately, though, was working with us, so that that was not in question. I don't believe you could have gotten a man of his ability during that period.

Q. During what period was this?

A. You mentioned 1941.

Q. Oh, yes, about the year ending June 30, 1941, is what I am asking about right now, June 30, 1941.

(Testimony of William James Kennedy.)

A. That is correct. I don't believe you could have [95] gotten men at that time.

Q. You mean at any price?

A. Yes, the etching business is rather an unusual occupation. There aren't very many people in the country that are skilled practitioners of the work.

Q. Just what were the capabilities of Mr. Hayek?

A. Well, he understands etching and plating and lithography, and tool and die making, machinery work, and mixing solutions, paints, colors, all of the special problems of metal finishing. In other words, he understands the nameplate business in all of the different departments connected with it, including working with decalcomanias and plastics and various things.

Q. During the years 1941 and 1942, were persons with those abilities available?

A. I never got one. I never had anybody so far that knew much about it.

Q. Well, assuming that you didn't have Mr. Hayek in the business, in the year ended June 30, 1941, and you would have to engage someone to take his place, what is your opinion as to what you would pay?

A. Well, in that case I would have had to try to find someone who was available and capable, and whatever he required, that I probably would have had to pay him.

(Testimony of William James Kennedy.)

Q. Well, you think you would pay \$5,000.00, or \$10,000.00, [96] or \$20,000.00?

A. I believe so. I understand that by his experience with etching, he is cheap at \$12,000.00 a year just for that one department alone.

Q. Now, taking for the year ended June 30, 1942, as compared with June 30, 1941, were the services of Mr. Hayek during that latter year worth more or less? A. They were worth more.

Q. For what reason?

A. Well, we were still completing a lot of commercial business, and going right into war business, and he was doing twice as much work a part of that time.

Q. Did you prepare a memorandum of the average number of employees of the Kennedy Nameplate Company in various years? A. I did.

Q. I show you a statement here, showing years as well as the number of employees, and ask you if you prepared or caused to be prepared that statement.

A. I did. This is my writing on the bottom.

Q. Does that show the number of employees of the Kennedy Nameplate Company as follows: Year ended June 30, 1937, 39; Year ended June 30, 1938, 36; Year ended June 30, 1939, 37; Year ended June 30, 1940, 53; Year ended June 30, 1941, 73; Year ended June 30, 1942. 90 employees.

A. It does. [97]

Q. Does that represent the average number of employees? A. It does.

(Testimony of William James Kennedy.)

Q. And this down below is just some——

A. That shows that maybe we would have 10 or 15 more than the average, and sometimes we would run short, maybe one or two less.

Mr. Orem: This is offered as Petitioner's Exhibit.

Mr. Tonjes: There is no objection.

The Court: It will be received as Petitioner's Exhibit No. 10.

(The statement referred to was marked and received in evidence as Petitioner's Exhibit No. 10.)

Q. (By Mr. Orem): Now with respect to the nameplate business, a business of that general type, was there very many companies in Los Angeles of that type? A. Not at that time.

Q. During 1941 and 1942?

A. There were just two, perhaps three, firms that made nameplates, and those firms were so very small, just getting started. I think there was one that had been an outgrowth of the plant started at Lockheed that had separated on or about that period. We unquestionably represented 75% of the business, I believe, during this period.

Q. What was the name of this firm that had some of the [98] other business created by Lockheed?

A. That was the Miller Dial & Nameplate Company on Santa Monica Blvd., and there was a small plant, the K. B. Nameplate Company, and there were one or two small firms in the downtown area.

(Testimony of William James Kennedy.)

Q. Now as the nameplate business stood at that time, during 1941 and 1942, if you had had to—say that your position or Mr. Hayek's, either one, had become vacant, what would those positions have been worth?

A. I don't believe that they could have been filled.

Q. You could have hired an executive from some other business, some business like plating or something like that, and readily teach him the nameplate business?

A. Well, a plater would probably be the best, but you wouldn't have anybody you could really take in unless you had trained him.

Q. Why would that be?

A. That plater also works with metals, using dangerous chemicals. A plater, I believe would learn how to handle that work, in terms of handling work with liquids and corrosives, and types of acids and solutions.

Q. Would a plater be familiar with all these other processes?

A. He would have that much learned, as I say, but he would not know anything about lithographing or camera work, or [99] anything in that department.

Q. Would he be capable of working and learning and taking over the management of that one department?

A. Yes, you might train him and break him in, sure, but there would have to be some limit.

(Testimony of William James Kennedy.)

Q. If you had had a vacancy such as I have just described, what would you have done about filling it?

A. Well, I don't know. I just used to wonder what I would do myself.

Q. Now the Kennedy Nameplate Company accumulates scrap from time to time, does it not?

A. They do.

Q. Will you describe just how you handled the sale of that scrap in 1941 and 1942?

A. The scrap which they accumulate is usually what we know as overs on jobs. In order to create enough good nameplates to deliver to the customers, the job is run more than the requirements, just for safety, and we know that as overs, and there will be slugs where there is bad cutting, something wrong about the cutting, or say a dial is hand marked and it is scratched, those are not used, and then we have problems from time to time with discolored nameplates, and all those that we cannot use are scrapped.

Q. What disposition do you make of those? Are they sold as scrap? [100]

A. Presently we handle that by the customary process of selling it, and the income goes to Mr. Hayek and myself on an equal basis.

Q. In other words, one-half to each?

A. That is correct.

Q. Was that treated as income of the corporation?
A. Never.

(Testimony of William James Kennedy.)

Q. Just what did you have in mind in distributing those proceeds to yourselves?

A. Well, it seems to be the practice within the name plate business, that it was kind of a bonus. That was a practice that was inherited by the Kennedy Nameplate Company. I didn't have anything to do with setting up the procedure in the first place.

Q. Of course that scrap was accumulated by the corporation, and the proceeds that were being distributed to these various individuals, had been shown on your income tax returns, yourselves and your wives?

A. That is right.

Q. Do you know how it was shown on your return?

A. I believe it was entered as part of my gross income, but I'm not sure.

Q. Will you take one of these returns, for the year ended June 30, 1941, being Respondent's Exhibit A, and note there in line 11 the sale of scrap metal, $\frac{1}{4}$, \$468.29. [101] That was $\frac{1}{2}$ of the half that you received, is it not?

A. That is correct.

Q. And the other half would be shown on your wife's return?

A. That is correct.

Q. And I show you Mr. Hayek's return for the same year, Respondent's Exhibit B, showing scrap metal, $\frac{1}{4}$, \$468.29, which represented the return by Mr. Hayek for the sale of scrap on his return?

A. That is correct.

(Testimony of William James Kennedy.)

Q. And the same procedure was followed for the year 1942, was it not? A. That is correct.

Q. Just what did you consider that? Of course it was an amount that came from the corporation, but would you consider that—well, it would have to be either compensation or dividends, just what would you consider it?

A. Well, I returned it as miscellaneous income.

Q. How did you regard it? Just what did you consider it, was it compensation or dividend?

A. I regarded it as a sort of a bonus to him and for myself.

Q. Now, these amounts that you received as compensation, bonus, etc., during the years June 30, 1941, and June 30, 1942, in your opinion was that reasonable compensation for the [102] services you rendered to the company?

A. Well, of course that is always a matter of opinion, but I don't believe I was ever overpaid by the Kennedy Nameplate Company.

Mr. Orem: That is all.

Cross-Examination

By Mr. Tonjes:

Q. Mr. Kennedy, I believe you stated that some corporations paid etchers as high as \$12,000.00 a year.

A. I didn't say they paid them that. I said I had been informed that they did. I don't know that to my own knowledge.

Q. I was going to ask you if you knew of any organization that paid an etcher that much, and

(Testimony of William James Kennedy.)

whether or not it compared with your organization in size.

A. Well, the amount of etching that is done by any individual etcher would be—a firm might have two or three etchers, and there might be two or three managers in charge of the firm—I remember that one firm in California, they had an etcher who necessarily had to be capable in the production field, and they paid their etcher \$35,000.00 a year.

Q. Do you know what their gross sales were?

A. Their gross sales of nameplates I couldn't say, but I know at one time their gross sales were about \$80,000.00 a month, what they have been selling recently I don't know, because I think they are getting out of the nameplate business [103] now, and so their sales are mixed up with their other items.

Q. I believe you also stated that in the event that you had to replace Mr. Hayek, you would have great difficulty in finding a man who would have his qualifications.

A. I am quite sure I would.

Q. I believe you were a little concerned, and said you could not find one.

A. I did not go so far as to say I could not find one. I don't know where we would find such a man.

Q. Did you ever make any effort to find a man like that?

A. Yes. It is not ethical to try to take your competitor's man, but I have had letters from various men working at other plants, which always stated their qualifications, which they submitted,

(Testimony of William James Kennedy.)

and no one ever applied for work with us there that knew any more than one single phase of the name-plates he had specialized in, with very full knowledge anyway, that knew how to coordinate these departments.

Q. What was the necessity for their making application to you?

A. Well, at times during the depression, there were many people coming back to California, and we even got some along the coast who wrote down, trying to secure work.

Q. I believe you also stated you had a system of paying a bonus to your employees.

A. Yes, sir, that is correct. [104]

Q. And that has been in effect for quite a few years? A. That is correct.

Q. Do you have any idea what the total bonuses paid your employees were, during the fiscal years ended June 30, 1941 and June 30, 1942?

A. No, I couldn't give you the figures, offhand. You know there was a period there where such figures again became available, but I don't recall them offhand. At a subsequent period the boys secured the bonus again, so I say that such a bonus is paid regularly, to everybody there, and we still continued to pay the bonus for salesmen, when we didn't pay it in the factory, because we knew we had had a problem on all of that payment.

Q. How many employees did you pay this bonus to?

A. Every employee who got a bonus, that was

(Testimony of William James Kennedy.)

anybody working for us 30 days, I think, we paid a hump \$5.00 for everybody working for us. If a man worked for us longer than 30 days he was entitled to a bonus.

Q. The thing I want is the total sum. What would be paid?

A. I don't know. I would say at the outside maybe \$12,000.00 or \$14,000.00 a year, maybe around there somewhere. It would vary depending on how many employees they had.

Q. Now, there was a matter on which the corporation made a report of its activities in regard to getting business, [105] we will say back in 1937 and 1938, in connection with that, did you have a sales department? A. Yes, we had.

Q. Did you have that same sales department in 1941?

A. In 1941 we started, about, I imagine, about the end of 1941 we concluded that war was inevitable, and with this additional sales organization we seemed to have a terrible number of commitments, they kept on sending us in orders.

Q. Yes, but your sales problems were more pertaining to getting orders filled, at the moment, that is, during the years 1941 and 1942?

A. Well, of course that is what it proved to be, but that was an afterthought. At all times the aircraft companies bought their merchandise on the open market. They bought it from us because we could supply their merchandise, and make it according to their specifications.

(Testimony of William James Kennedy.)

Q. Well, the point I am making is, you didn't have to maintain this same type of agency to sell your goods that you were producing during those years?

A. We didn't reduce a single bit our sales department. Our men were simply used to send to various plants, and we had to keep about the same personnel.

Q. I take it that during the years 1941 and 1942, the greater volume of your business then was in connection with [106] the war activity?

A. There was a deviation there, yes; the commercial business was becoming less and the military business was increasing, and at the end of 1942 they had practically eliminated the commercial producer, making goods for the commercial producer.

Q. Is it true or not that the same amount of production, or the same amount of business volume, would have resulted in considerably greater dollar volume of sales?

A. I don't think I know just what that means. What do you mean by that?

Q. I mean were prices of articles sold by you generally higher in 1941 and 1942?

A. No, we used the same prices.

Q. Higher in 1941 and 1942 than they were back in 1937 and 1938?

A. We used the same prices.

Q. During the year 1940, according to the exhibit offered in evidence, you had approximately 53

(Testimony of William James Kennedy.)

employees. Do you know of any other organization in the nameplate business in the west at that time, on the west coast preferably, but anywhere in the west, that employed approximately that number of persons?

A. No, I don't. I don't know. There are unquestionably some companies, but I don't know, I don't know how they [107] compare in size to ours. I know there are some larger, and unquestionably some smaller, but I don't know how many employees they had. [108].

Q. Now, getting back to your compensation for the years 1941 and 1942, ending June 30th, prior to this I believe you testified that some portion of the \$34,000.00, several thousand dollars of it for Mr. Hayek particularly, was for services which were rendered in prior years. I believe you testified to that.

A. I think there was a misunderstanding as to how much [109] that was. I testified we were paying him back for the years he hadn't received it. It was not intended in that way, but it was being paid to him for work that he had done before, but the condition that induced the company to pay at this time was doubtless due to the fact that the company had paid such extremely small salaries during the period of development and he had worked at that time for so little. I was working for as low as \$50.00 a week at one time in the depression myself.

Q. I notice that the salary paid in 1940 totals

(Testimony of William James Kennedy.)

somewhat in excess of \$24,000.00. I presume that was at the rate of \$12,000.00.

A. That was approximately \$12,000.00 apiece.

Q. For 1940 there were 53 employees and net sales of \$51,000.00. Do you know any organizations, any companies in the nameplate business that had approximately that number of employees and that volume of business, who paid more than \$24,000.00 to the officers?

A. I don't know what any of them were paying, and I never made any effort to try to find out.

Q. Your sales were less for 1938 and 1939 and the salaries paid in those years were practically \$37,000.00 and \$15,000.00 or thereabouts. Do you know of any organizations that had approximately these sales who paid their officers the same salaries?

A. Well, let me see. I couldn't tell you what anybody [110] pays, based upon what their sales are. In the nameplate industry you pay a certain amount for so-called wisdom and experience, and in figuring the salaries of individuals on the basis of being an expense, if you will check your records you will find that it moved up from 98 to 109, from 109 to 151 thousand dollars which appeared to be quite an increase in proportion to the volume increase, but your cost, you have to carry over most of your basic costs, you will find a much higher ratio of profit with war work.

Q. I think that is true in all industries. Do you own any other stocks or securities, Mr. Kennedy?

A. You mean do I personally own?

(Testimony of William James Kennedy.)

Q. Yes. A. Yes, I do.

Q. What factors do you take into consideration when you buy stocks or securities?

A. Well, first I look back to see how many years they had paid dividends, how many years they have skipped dividends, what they are paying according to what they are earning, and what kind of business they are in.

Q. Now, looking at the investment in the Kennedy Nameplate Company as an investment, and also taking in consideration the fact that corporation paid dividends in 1936, '37 and '38 and has not paid any dividends since that time, would you say from an investor's point of view that was [111] a good investment?

A. In the first place there was no investment point of view involved, because the stock was not for sale if anybody would buy. It became increasingly apparent to me that we needed a bigger plant, and we started putting the dividends back to accumulate to buy a bigger plant. Likewise, we considered we needed new equipment, so that the last dividend paid in 1938 represents the expansion of this company and the procuring of the building on this property on Boyle Avenue, we started to get money together from this point and put it back into the corporation to put the corporation in a position to expand and get bigger and to keep on growing.

Q. Well, can you also, based on the salaries paid to the two officers——

(Testimony of William James Kennedy.)

A. I believe that is a matter of record in the exhibits.

Q. Yes. How do you reconcile the increase in officers' salaries by \$10,000.00 a year over a period of several years with the fact that the corporation was so anxious to retain its funds that it could not pay any money out as dividends?

A. Well, in the first place, while those two things may seem to be tied in, human beings remain human beings. It is necessary to encourage and promote business by adequate compensation. You can understand that the officers of a corporation are entitled to recognition for their efforts as well as their employees. The money could be paid and still some [112] additions made to the surplus funds for promotion, because there was a substantial profit being earned, and it would not necessarily have cost—at this time the program being initiated looked to a very bright and brilliant future, so the two things, while they might seem to have been different, they were not. They were simply going to make an effort to have an adequate plant and employ a lot of people and to buy a lot of new equipment, and we had to have officers who were satisfied with what they were obtaining, because they could have gotten more elsewhere.

Q. Yes, but don't you think that capital is entitled to some compensation for the use of its money?

A. The capital was here. You will find that there was substantially all of our working capital

(Testimony of William James Kennedy.)

tied up at this period. It was not depriving the capital of its premium, because they were just simply building it up at that particular period. There were definite plans made in those periods to get some more property, because we were unable to stay on the property we had. I drove over the entire area and I investigated many piece of property in that district before I found the one that we ultimately bought, which was on Boyle Avenue.

Q. And that is still in the same condition as when you acquired it, is that true?

A. How do you mean in the same condition?

Q. There hasn't been any substantial development of it, I mean.

A. Well, I don't suppose that it has decreased any in its valuation.

Q. I believe you also testified that you supervised the keeping of the accounts.

A. Well, I have an accountant working for me, and I received a financial statement every 30 days showing the profit and loss and the purchases, and I don't personally do any thing on the ledgers to get a list of all the accounts that are not paying, but I get that every 30 days and go over all of the accounts.

Q. You have a regular accountant that takes care, you say——

A. Mr. Memory does not have anything to do with our books, but he checks up the books, and he makes a report to me and reports on how the books are being kept, and any recommendations

(Testimony of William James Kennedy.)

that he makes are certainly put into effect. Incidentally, I was an accountant myself. I never worked at it, but I understand accounting to that extent.

Mr. Tonjes: I think that is all the questions I have of Mr. Kennedy.

Redirect Examination

By Mr. Orem:

Q. Did you have any offers on or about the year 1941 or [114] 1942 or later for the sale of the company, the Kennedy Nameplate Company?

A. Yes, I did.

Q. Who made this offer?

A. It was made by the Northern Engraving Company of Racine, Wisconsin.

Q. And when they made this offer, did they offer anything to yourself and Mr. Hayek to stay on as employees? A. Yes.

Q. Pardon me. What was the date of this?

A. The spring of 1943, I think, February or March. I am not sure.

Q. In connection with that offer, did they attempt to make any arrangement to keep you on as an employee?

A. Well, I can reply to that——

The Court: Not in too many words since the question is a direct one that is being asked by Mr. Orem.

Q. (By Mr. Orem): Give the details of the offer.

(Testimony of William James Kennedy.)

A. They called me on the long distance telephone, called me and asked if the company was for sale. After I discovered who was talking, I said, "Let me read you the balance sheet, and if you are talking that kind of money then we will talk turkey." So I read the balance sheet off over the long distance wire to this man. He said, well, he [115] will discuss it with his associate and he will let me know. I put the matter away in the back of my mind, because those things have a way of disappearing. About two weeks afterwards a call came through over the long distance telephone and said they had given the matter very thorough consideration and they would talk business that would apply to the costs stated on the balance sheet.

They came out here and I happened to be at home. I was ill at the time, so they came to my house and they sat around discussing various things, and the offer was to buy a 51 per cent control of the company, and engage me and Mr. Hayek for two years, and they mentioned the sum that they were ready to pay. They were going to buy 51 per cent of the stock and to keep me running it. They did not deal with Mr. Hayek, because I wouldn't commit myself to taking that amount for the business. So that is the way we broke down, because in the first place they were not offering enough money for 51 per cent interest, and again I was not going to work myself out of the business.

According to the plan and policy they contemplated they were going to send their operators here

(Testimony of William James Kennedy.)

and at the end of the two years they would be the true stockholders of the company.

Q. What compensation were you to get?

A. I told them what I was earning, that I was getting \$10,000.00 plus a bonus. [116]

Q. Do you recollect what that amounted to?

A. I told them I was earning \$17,000.00 a year.

Q. Did you tell them what Mr. Hayek was earning? A. The same. [117]

Q. Now, one of your customers, I believe, was Consolidated Aircraft.

A. Consolidated Vultee.

Q. Consolidated Vultee, pardon me. They were large customers of yours, were they not?

A. They were quite large customers during the war.

Q. Did you make any deliveries of your products to their plants besides the one in San Diego?

A. Oh, yes, wherever they had a plant.

Q. How was that particular customer obtained?

A. Well, I guess that I obtained it.

Q. What was their procedure in—first, state just what you did furnish them for use in their plants.

A. We sold them plates in quite large numbers of various kinds.

Q. Well, there is an arming chart on that list. Did you make similar charts to that?

A. I did, yes, dozens of different ones.

Q. Did you make any money out of that business?

A. In all of our aircraft jobs we did pretty

(Testimony of William James Kennedy.)

good. The work was very highly specialized, and they didn't say what the use of the plate was going to be. They would place the order and he would make delivery of it. As soon as they told me what was necessary and the number they needed, they got the plates.

Q. Well, those charts that you made for Consolidated and some of these other things, just what type of skill was required in respect to your employees, just what type of skill?

A. Well, that bombing chart, you see, that is a machine that was worth \$15.00 apiece, and that is about the same as a slide rule, where the slide operates in that position, and it has to be correctly made.

Q. With reference to the bombing chart, how many processes did you have to go through and what would be included in those processes? [119]

A. Consolidated Vultee Aircraft Company made the original office blue prints. They always had the Consolidated man make the drawing and called us in later. I visited the Consolidated engineering department and we discussed the possibility of making it up as a painted product. Well, I said it looks like the kind of a job which would cost a lot of money. I am willing to take that along and see what it costs and we will take a shot at it.

I brought it back to Los Angeles to the plant and we talked it over in consultation with Mr. Hayek, and we looked it over and then we decided that we

(Testimony of William James Kennedy.)

could reduce it in cost by making it out of laminated plastic. It is a very complex job.

Q. What were the employees that actually worked on it?

A. Well, our artist made the drawing for the chart, and he was responsible for the accuracy of the drawing, and the photo-engraver then had the job of making each one the right size.

Q. Were those unskilled employees?

A. Oh, no.

Q. Or are they semi-skilled?

A. They are skilled.

Q. Do you have any common labor at all in your plant?

A. Well, you can't hire anybody that comes into a nameplate company and expect him to start doing the work [120] properly. They are usually a kind of a tool maker or an artist, he knows something about his job before he comes in there.

Q. In other words, all your men are skilled in various parts of the work in your plant?

A. Yes, they have to be able to handle some details of it, at least.

Mr. Orem: That is all.

Mr. Tonjes: No further questions.

The Court: We will recess for ten minutes.

(A short recess was taken.)

Mr. Orem: Mr. Miller, will you take the stand, please?

Whereupon,

CHARLES W. MILLER

called as a witness for and on behalf of the Petitioner, having been first duly sworn, was examined and testified as follows:

Direct Examination

By Mr. Orem:

Q. Will you state your full name?

A. Charles W. Miller.

Q. What is your present business or occupation?

A. I am president of the Miller Dial and Nameplate Corporation.

Q. Do you devote all of your time to that business? [121]

A. Yes, I do.

Q. Is that a corporation? A. Yes, it is.

Q. When was it incorporated?

A. It was incorporated on the 1st of January of this year.

Q. Where is that located?

A. 781 East Washington Boulevard.

Q. Los Angeles? A. Los Angeles.

Q. Now, prior to the incorporation, what was your business connection?

A. It was a partnership.

Q. Under the same name?

A. Yes, the same name, Miller Dial and Nameplate Company.

Q. That corporation acquired the prior partnership business? A. Yes, it did.

Q. How long were you a partner in the Miller Dial and Nameplate Company?

(Testimony of Charles W. Miller.)

A. I was a partner in the Miller Dial and Nameplate Company since 1939 to, let's see, the partnership started in 1939 and lasted through until the first of this year.

Q. Did you have prior experience prior to 1939 in the nameplate business? [122]

A. Yes, I have had experience in the nameplate and dial business since 1930.

Q. Was that in an executive or administrative capacity, that is, management?

A. All except the first two years.

Q. Now, in business in the partnership form in Los Angeles during the years 1941 and 1942, during the years ended June 30, 1941, and June 30, 1942, who was your principal competitor in Los Angeles particularly in the type of business in which you were engaged?

A. Kennedy Nameplate Company.

Q. And are you acquainted with Mr. Kennedy and Mr. Hayek? A. Yes, I have met them.

Q. Do you have any personal knowledge of their reputation in the nameplate business?

A. They are generally acknowledged to be one of the finest houses on the coast.

Q. Do you have any personal knowledge of the individuals with respect to the business, do you know what Mr. Hayek's capacity is?

A. Yes, I understand that Mr. Hayek is the president of the corporation, that he runs the shop. Mr. Kennedy runs the office, very similar to my position.

(Testimony of Charles W. Miller.)

Q. Now, how would your duties in your business compare [123] with those of Mr. Kennedy in his?

A. Mr. Kennedy's and my duties would be exactly the same. I take care of all the sales and the business administration of the company, the same as I understand Mr. Kennedy does.

Q. How would Mr. Hayek's duties compare with those of any individual in your firm?

A. They would be exactly the same as my brother. He takes care of all production or production problems, handles the whole factory.

Q. What is his name?

A. John Dawson Miller.

Q. Was he a partner in your partnership business? A. Yes, he was my partner.

Q. And he is an officer of the present corporation?

A. He is the vice-president of the present corporation.

Q. Now, assuming the following facts to be true: That Mr. Joseph W. Hayek had 34 years of management experience in the nameplate business, that he was president of the Kennedy Nameplate Company during the year ending June 30, 1941, in full charge of all production and technical activities, that he engaged in no outside business and worked from 12 to 14 hours per day for five days a week and about half that on Saturday of each week: that the net sales for the company for the year were \$256,000.00; that the average number of employees was 73; that the income after all expenses [124] other

(Testimony of Charles W. Miller.)

than Federal Income Tax was \$46,942.00; that the invested capital of the company was \$67,000.00 at the beginning of the year; what would you consider that the services of Mr. Hayek with Kennedy Nameplate Company in the year ended June 30, 1941, were reasonably worth?

Mr. Tonjes: I object to the question, your Honor, on the ground that this witness has not been qualified to express an opinion as to the fair value of the services of Mr. Hayek, for the reason that it has not been shown that he was engaged in the business in 1941 in corporate form, and has not been shown to have any personal knowledge of what other organizations of a similar nature paid, or has not been in any way qualified.

Mr. Orem: May I ask a few further qualifying questions? I will withdraw that question for the present.

The Court: You may, yes.

Q. (By Mr. Orem): During those years, Mr. Miller, 1941 and 1942, at any time did you contemplate having to engage somebody to take over your position?

A. Yes, I was trying to get someone to take my place so I could go into the Air Corps.

Q. About what time was that?

A. Well, let's see, that was in 1942.

Q. Now, was your volume of sales in 1941 and 1942 fairly [125] comparable to those of the Kennedy Nameplate Company?

(Testimony of Charles W. Miller.)

A. I didn't hear you mention the amount for 1942. 1941 was comparable.

Q. Well, would sales of 1942 of \$370,000.00 be fairly comparable to the sales of your organization?

A. It would be close to it, yes.

Q. With respect to engaging this individual to take your place, did you actually engage him?

A. Yes, I hired him on a six months' trial to try and take my place, and he worked for us for six months and couldn't do it, so I couldn't get away.

Q. Was he the best qualified individual you could find on the market in 1942 to take your place?

A. Yes, he was. He was the west coast sales manager for the Wayne Pump Company. He was very well qualified as a sales manager, but had no knowledge at all of the nameplate business.

Q. What salary did you have to pay him?

A. \$600.00 a month.

Q. And you found he was not qualified to take your position?

A. That is correct. I paid his expenses and mine, but I never did get away.

Mr. Orem: I now offer that question Mr. Tonjes was objecting to. [126]

Mr. Tonjes: I renew my objection.

The Court: I think I will have to sustain the objection. If this witness had been in a comparable business during those years, but I understand it was a partnership, and they probably didn't pay any salaries.

(Testimony of Charles W. Miller.)

Mr. Orem: I am in a position to show just what salaries were paid to Mr. Miller by the partnership.

The Court: Well I think that would be relevant evidence for that. The two businesses, as I understand, are comparable in at least the nature of their business. How did they compare in point of sales, volume of business?

Mr. Orem: Well, Mr. Miller has stated that they are fairly comparable. I might ask him to tell me just exactly what their sales were, but I didn't want to pry into his business if I could help it.

The Court: Of course, your salaries are in evidence, admitted as to what salaries might be paid for their experience. There ought to be some showing that their volume of business was comparable in amount before it would be worth much in the way of testimony, I think, but that being shown, then I think it would be relevant to show what salaries were paid to Mr. Miller, who had, as I understand it, duties corresponding to those of Mr. Kennedy.

Q. (By Mr. Orem): I want to ask you, Mr. Miller, just what were your [127] sales for the fiscal year ended June 30, 1941.

A. I don't remember exactly.

Q. Can you approximate the amount? I believe you are on a calendar year basis, are you, that is, your books are on a calendar year basis?

A. Yes, they are.

(Testimony of Charles W. Miller.)

The Court: I think that wouldn't make any difference.

Mr. Orem: Yes, but it might cause him a little trouble to estimate it.

The Witness: Rather than guess at it, if I can use the telephone a few minutes I will find out exactly. I don't like to guess at it, because I just don't remember.

The Court: Well, he has a right to do that if he can, because I think in order to testify as to what salaries were paid in his business, there would have to be some showing as to the volume of business that was transacted. As I understand it, the witness has testified that the nature of that business was comparable, is that true?

The Witness: That is correct. It is identically the same.

The Court: All right, we will recess for five minutes to let him get that.

(A short recess was taken.)

Q. (By Mr. Orem): I will ask you, Mr. Miller, what were the total [128] sales of your company for the calendar year 1941?

A. Approximately \$156,000.00.

Q. And what were your sales for the calendar year 1942?

A. Approximately \$338,000.00.

Mr. Orem: I now offer the question that I previously asked, the hypothetical question, once more.

Mr. Tonjes: I object to the question, your Honor. This witness has testified what he would have had to pay to an individual to come in and per-

(Testimony of Charles W. Miller.)

form the duties which, in his estimation, were comparable to those performed by Mr. Hayek, I submit that he is not qualified to testify as an expert.

The Court: Well, he is not asking the question, as I understand now, as to how much was paid the witness by his own concern as a salary, is that so?

Mr. Orem: No, I didn't. I can ask that question, however. The reason I didn't ask that question was that from a tax standpoint the entire profits of the partnership are taxable.

The Court: That is very true. However, I think if they had an arrangement to pay their two men that were comparable to Mr. Kennedy and Mr. Hayek, I think maybe he might testify as to what salaries had been agreed upon. So far as qualifying this witness as an expert for salaries paid [129] in the industry, I don't think he could do that. I don't believe that he would be qualified as an expert in that line.

Mr. Orem: Of course, there are only two firms in that line in Los Angeles.

The Court: Yes. Well, you might inquire if he and his brother, who held positions similar to Mr. Kennedy and Mr. Hayek, if they had a salary arrangement, and if so, what salaries were paid to each by the partnership. I think that might be admissible.

Mr. Orem: Very well.

Q. (By Mr. Orem): For the calendar year 1941, Mr. Miller, what were the total salaries paid by your firm to the two partners?

(Testimony of Charles W. Miller.)

A. We didn't have any standard salary. We drew out, we made withdrawals as we needed it on an equal scale.

Q. Do you know approximately what they were for 1941?

The Court: Well, I don't believe that would be of any value to the Court, as to what they might have drawn, and I am not so sure that even if they had called it a salary arrangement as a partnership it would be relevant. However, it is, I think, a matter of common knowledge that sometimes in partnerships, especially if there are some inactive partners, those that are active are paid a salary as a salary, and if we had something of that kind here I think it would be admissible, and it might be of some advantage to the Court. But [130] apparently they didn't.

The Witness: In 1942 we had, your Honor. In 1942 we drew a salary.

The Court: Then you may testify as to 1942.

Q. (By Mr. Orem): Very well. What salary did you draw during the calendar year 1942?

A. I drew \$24,000.00.

Q. What did your brother, Mr. Dawson Miller, draw?

A. Dawson drew about \$18,000.00.

Q. So the total salaries of the two individuals for the year 1942 then would be \$42,000.00?

A. Yes.

Q. And your sales for the year were \$320,000.00?

A. That is right, \$338,000.00.

(Testimony of Charles W. Miller.)

Q. Are you familiar with the salaries paid to executives in the nameplate industry generally?

A. I am familiar with those paid at Northern Engraving Company at La Crosse, Wisconsin, which is a good nameplate house. They have two brothers there similar to myself and my brother, and they each draw \$25,000.00 a year.

Q. And the other firm you mentioned?

A. Well, the Northern Engraving Company and I am not familiar with those at Crowe Nameplate Company. They are the only two large nameplate companies that I am familiar with. [131]

Q. Well, there are very few nameplate companies in the country, is that true?

A. Well, comparatively to other businesses, there are few, yes.

Q. And in this vicinity, are there any other nameplate companies at all that are comparable to Kennedy?

A. Well, I would not say that there are any that are comparable. There are a few other small houses, but there is none that is comparable.

Q. There are none any larger, are there?

A. Oh, no.

Mr. Orem: I submit to the Court that with only two nameplate companies here it is impossible for—

The Court: Well, I think after all that those salaries paid by other concerns are not so very important. The witness has testified as to his salary and his brother's salary in 1942. I have received

(Testimony of Charles W. Miller.)

that testimony for what aid it may be to the Court. Of course, I think the important things you have already covered, that is, the volume of business and the profits of the business and the work that those men did, and all of that addresses itself to the Court as to whether the salaries are reasonable or not. Anything else that you may have to offer that you think would be relevant——

Mr. Orem: In other words, the Court would not feel that the answer to the hypothetical question would be of any [132] particular value, if he was allowed to state?

The Court: What his opinion is as to the reasonableness of those salaries?

Mr. Orem: Yes.

The Court: Well, I think I will admit it, notwithstanding Mr. Tonjes' objection, because of his familiarity with the business, and they are located here in the same city, as I understand it.

Mr. Orem: That is true, quite close together.

The Court: Your question now, you may examine him on that point that you started on.

Q. (By Mr. Orem): Assuming the following facts to be true, Mr. Miller, I will ask you your opinion: Assuming that Mr. Joseph W. Hayek had 34 years of management experience in the nameplate business, was president of the Kennedy Nameplate Company during the year ending June 30, 1941, in full charge of all production and technical activities; he was engaged in no outside business, he worked from 12 to 14 hours per day five days per week

(Testimony of Charles W. Miller.)

and about half that on Saturday; that the net sales of the company for the year were \$256,000.00; that the average number of employees was 73; that the net income after all expenses other than Federal Income Tax was \$46,942.00; the invested capital was \$67,000.00 at the beginning of the year; in your opinion what would you consider a reasonable [133] compensation for the services of Mr. Hayek to the Kennedy Nameplate Company for the year ended June 30, 1941? That figure of \$46,942.00 before Federal Taxes, of course, was after officers' salaries and all other expenses.

The Court: You might first ask him does he have any opinion as to what would be a reasonable salary in that connection?

Mr. Orem: Yes.

Q. (By Mr. Orem): Do you have an opinion as to what a reasonable salary would be, Mr. Miller?

A. Judging from that—

Mr. Tonjes: Answer yes or no.

The Court: First, do you have an opinion, before you can give it.

The Witness: Yes, I have an opinion.

Q. (By Mr. Orem): What is your opinion?

A. My opinion would be based judging on how much more business they did compared to what we did, what I received, I think \$20,000.00 a year would be a fair salary for the job.

Q. Do you base that opinion purely on what you yourself were receiving?

(Testimony of Charles W. Miller.)

A. On the amount of his particular company as compared to our own. [134]

Q. In forming that opinion, do you take into account your knowledge of the nameplate industry?

A. Yes, because you can't hire men to do this work. That only comes through many years of actual experience in the work itself.

Q. Then assuming the following facts to be true: That W. J. Kennedy was the secretary-treasurer of the Kennedy Nameplate Company during the year ending June 30, 1941, in full charge of the office, finances, sales, credits, advertising, all other activities other than production; he engaged in no outside business but those of management of a concern in the nameplate business and worked from eight to ten hours per day five days a week and about half that on Saturday, which is about 55 hours a week, and that the sales and other financial figures were just as previously stated in my previous question with relation to Mr. Hayek for that same period, would you have an opinion as to the reasonable value of the services of Mr. Kennedy in the Kennedy Nameplate Company for the year ending June 30, 1941? A. Yes.

Q. In your opinion what would those services be worth?

A. I believe they would be worth the same as Mr. Hayek, \$20,000 a year.

Q. On what do you base that opinion?

A. I base that opinion the same as the other, on the [135] amount of experience required in that

(Testimony of Charles W. Miller.)

job and the fact that there is no other man available for that type of work.

Q. Assuming similar facts for the year ending June 30, 1942, with respect to the hours of labor and the capacity and so forth of the individuals, but with the financial figures as follows: Sales \$364,000, average number of employees 90, the net income after all expenses including officers' salaries, excluding federal income tax was \$91,747, its invested capital was \$97,000 at the beginning of the year; do you have an opinion as to the value of the services of Mr. Hayek and Mr. Kennedy to the Kennedy Nameplate Company for the year ending June 30, 1942?

A. Yes.

Q. And in your opinion what would the services of each of those men be worth to the Kennedy Nameplate Company for that year?

A. I believe that due to the increase of business and responsibilities, that they should receive at least \$25,000 apiece.

Q. Now, assuming that the positions of either Mr. Hayek or Mr. Kennedy had become vacant due to the death of either one or any other cause during the years 1941 and 1942, can you estimate what salary the Kennedy Nameplate Company would have to pay an individual capable of filling those positions of either of those men? [136]

A. I don't know where they could find such a man.

Mr. Orem: That is all.

(Testimony of Charles W. Miller.)

Cross-Examination

By Mr. Tonjes:

Q. I believe you stated that you would pay a greater salary for the year 1942 than for the year 1941? A. Yes.

Q. Why would you do that?

A. Because of the increased volume of business, which means a large increase in the number of orders that each man had to handle and keep track of, following them up, and through my personal experience of how much pressure was put on during those war years to get out rush jobs.

Q. Do you know whether or not the average prices during 1942 were anywhere near in line with those in 1941 or were they greater?

A. The prices of nameplates, you mean?

Q. Yes.

A. I imagine the price for the individual nameplate was lower.

Q. You mean they could put out a nameplate cheaper in 1942 than they could in 1941?

A. I did myself. This was due to the use of increased facilities.

Q. And volume of production I suppose? [137]

A. Right.

Q. Do you know whether or not the major portion of the increase in business of nameplate companies generally was due to the war activity?

A. I believe it was.

Q. In other words, the increase in the volume of business which could be attributed to civilian

(Testimony of Charles W. Miller.)

consumption, I guess you could use that expression, would be very slight, probably a decline, would it not?

A. That is correct.

Q. And by and large the business handled during the years 1942 and 1941 as compared with ordinary years was sold to a fewer number of customers but in larger volume, is that true?

A. Yes, I believe that would be true.

Q. That fact would have some advantages with regard to simplification of operations, would it not?

A. Well, not entirely. They had an awful lot of small orders for individual ships that required special handling. I would say that we had more orders as well as larger volume to handle.

Q. You mean making a greater variety of products?

A. That is right.

Q. Yes, but with regard to contacts such as sales and credit considerations and things of that sort, there was some simplification in the operation?

A. There is a simplification of the credit, but not of the sales, because while they didn't have to go out and contact for sales, they had to go right in the engineering departments of the various factories and follow jobs constantly. Now quite naturally the green engineers would draw up jobs that they evidently didn't know about from experience, and we would have to go in and treat with them.

Q. What were the circumstances in connection with your own business which prompted you to change from a method of distribution of profits to a salary for yourself and your brothers? In other

(Testimony of Charles W. Miller.)

words, am I correct in understanding this, that in 1941 you and your brother had no salary arrangement, merely a drawing account arrangement, is that right? A. That is right.

Q. And in 1942, you changed to a system where you would draw a salary, you would draw a certain salary?

A. I had some outside activities at that time and he didn't have any.

Q. I see. Was that the reason why this salary method was adopted? A. Yes.

Q. Can you state approximately what the profits of the business were during the years 1941 and 1942?

Mr. Orem: I object to that as being irrelevant.

Mr. Tonjes: I think that is a good measuring stick, your Honor, as to the reasonableness of the salary. After all, that is about the best test there is.

The Court: You mean in his business?

Mr. Orem: You are not testing the reasonableness of Mr. Miller's salary though, are you?

The Court: Well, I suppose you would be, because you are comparing it. It was introduced for the purpose of comparison. I think so. You may answer that.

The Witness: Our profits for 1942 were \$119,000.

Q. (By Mr. Tonjes): For 1942?

A. Yes.

Q. Do you recall what they were for 1941?

A. No, I don't.

Mr. Tonjes: That is all.

Mr. Orem: That is all.

The Court: Very well.

(Witness excused.)

Mr. Orem: I will call Mr. Thorson to the stand.
Whereupon,

CARLISLE JOHN THORSON

called as a witness for and on behalf of the petitioner, having been first duly sworn, was examined and testified as follows: [140]

Direct Examination

By Mr. Orem:

Q. Will you state your full name, please?

A. Carlisle John Thorson.

Q. What is your present business connection?

A. Corporate financial adviser.

Q. Just what does that consist of, Mr. Thorson?

A. Well consultation with corporations on financial problems, analysis, negotiation of corporate financing, reorganization work, negotiating loans and credit.

Q. Does that include any advice in regard to corporate salaries of executives?

A. Well, not directly or specifically, but it is involved in practically all of my work one way or another.

Q. Just briefly tell the background of your general business experience in the last twenty years or so.

A. Well, I am an attorney by profession.

(Testimony of Carlisle John Thorson.)

Q. In what state?

A. Colorado. I have followed financial work since graduation from college.

Q. When was that? A. 1914.

Q. Well, I mean have you been a financial adviser, independent financial adviser, continuously?

A. No. I first became associated with an investment [141] banking house having to do with the underwriting of securities, and then with the First National Bank in Denver, subsequent to the war with the First National Bank of Omaha, and in 1922 with the California Bank of Los Angeles.

Q. In 1922 with the California Bank of Los Angeles; how long did those services continue?

A. Until 1928.

Q. And what was your capacity there at that bank?

A. I was treasurer of the bank and manager of its corporate finance department.

Q. And in that connection was part of your work reviewing corporation balance sheets and profit and loss statements?

A. Yes, that was incidental naturally to considering corporate finance and underwriting securities, corporate trusteeships.

Q. What happened after 1928?

A. I left the bank to engage in my professional work as a financial adviser.

Q. That continued to what date?

A. Well, that continued until the fall of 1941, when I closed my office to undertake reorganization

(Testimony of Carlisle John Thorson.)

of a bank. On the completion of that in 1944 I became identified with the Air Corps.

Q. From 1941 to 1944 you were reorganizing that bank. What bank was that? [142]

A. San Diego Trust & Savings Bank of San Diego.

Q. And in connection with that reorganization, what was your official position there?

A. Vice president.

Q. And what were you vice president of, in charge of what? Was there a terminology there, department, vice president in charge of?

A. Well, I can best answer your question by explaining how I came to go there if that is in order. It is rather hard to specifically answer your question. I had been retained for a period of ten months by the bank to make an analysis of its trust department, the mortgage loan department and the real estate department, and concluded with my report making recommendations as to what should be done. The man that was coming into the bank to carry out those recommendations upon approval of the report was stricken with heart trouble and I was asked to come down to carry on my own recommendations. My going was not with the thought of permanency, but to effectuate the program contemplated by my recommendations, I had to be an officer of the bank.

Q. Did you have anything to do with corporations and corporate loans, anything of that sort during those years?

(Testimony of Carlisle John Thorson.)

A. Oh, yes. I was on the commercial loan committee, executive committee, real estate loan committee, and was in addition to that the trust officer.

Q. When a corporation came in there for a loan, just what was the procedure?

A. It was usually analyzed by the credit department and submitted to the commercial loan officer and then in turn submitted to the commercial loan committee, and then the loan if made was ratified by the board of directors loan committee.

Q. What did you do along the line of those particular loans in 1941 and '42, we will say?

A. Well, as a member of the commercial loan committee I naturally reviewed all the applications that were recommended by the loaning officer.

Q. Did that include balance sheet and profit and loss statement?

A. Very often, yes, most often.

Q. Did the balance sheets include statements of surplus and working capital and those general figures? A. Oh, yes.

Q. Did the profit and loss statements include sales and profits and officers' salaries and so forth?

A. Ordinarily, yes. If we had any reason to question salaries and the information did not appear specifically, we asked for a breakdown.

Q. When you were making a corporate loan, would the trust company take action with respect to the officers' salaries? [144]

A. Occasionally.

(Testimony of Carlisle John Thorson.)

Q. Have you ever found them too low or too high in your opinion from time to time?

A. You frequently find them both ways. Occasionally you are not getting adequate management because of too low salaries and banks sometimes qualify the granting of a loan upon getting more competent management. All other times you do occasionally find salaries out of line.

Q. About how many balance sheets, profit and losses statements of various corporations showing officers' salaries did you review during 1941 and 1942? A. That would be hard to say.

Q. Well, just roughly.

A. I cannot recall that.

Q. Would it be 10 or 5.

A. Well, it wasn't a very large commercial bank, as far as commercial loans go. I presume in a period of a couple of years maybe 150 to 200 of those commercial loans were analyzed thoroughly. You only use the balance sheet and profit and loss statement method when it is a loan of some substantial size.

Q. Now, taking your entire experience from 1922 when you went into the California Bank corporation department up to the present time, how many balance sheets and profit and loss statements of corporations showing officers' salaries [145] do you estimate that you have reviewed, if you can make such an estimate?

A. Well, it would be just a wild guess, Mr. Orem. I daresay I have analyzed the organiza-

(Testimony of Carlisle John Thorson.)

tional setup of more companies since I have been practicing for myself than I did while with either bank, because usually those transactions are screened before I get to them, the credit department screened out those applications.

Q. Well, I mean since you were in the course of your practice; how many years by the way have you practiced as a financial adviser?

A. Thirteen years before the war and then I just resumed now in the last six months.

Q. During that time about how many corporate balance sheets and profit and loss statements have you examined?

A. Oh, a wild guess would be three or four hundred.

Q. Were they in various types of industry?

A. Varied, yes, widely diversified.

Q. You have had some opportunity of judging the amount of corporate salaries paid in San Diego during 1941 and '42 and comparing them with Los Angeles, haven't you?

A. Well, I had no occasion during 1941 and 1942 to make comparisons with Los Angeles, if that is what your question contemplates. Did you ask if I had occasion to make comparisons? [146]

Q. I mean with salaries at San Diego compared to Los Angeles, whether they were actually higher or actually lower.

Mr. Tonjes: Do you know?

The Witness: Frankly I do not know.

(Testimony of Carlisle John Thorson.)

Q. (By Mr. Orem): You have been in this courtroom since this case started this morning?

A. Yes.

Q. Continuously? A. Yes, sir.

Q. Have you listened to all the questions that the counsel have asked and the answers of the several witnesses? A. Yes.

Q. And did you hear the hypothetical questions that were asked of Mr. Miller? A. Yes.

Q. Now, should I ask you the same hypothetical questions, do you have an opinion as to the value of the services of Mr. Kennedy and Mr. Hayek or either of them to the Kennedy Nameplate Company for the years ending June 30, 1941, and June 30, 1942, or either year? A. Yes.

Q. Will you state what in your opinion the services of Mr. Joseph Hayek were worth to the Kennedy Nameplate Company [147] in the year ending June 30, 1941?

Mr. Tonjes: I object to the question, if your Honor please, for the reason that this witness is not qualified. I think Mr. Kennedy and Mr. Miller both emphasized the fact that this nameplate business was a highly technical business and the ordinary business experience of a person would have very little bearing on making him qualified to be the operator of a nameplate business, and this witness has not shown that he has any knowledge of any corporate or organization activity in the nameplate business. Until that is shown I submit he is not qualified to express any opinion.

(Testimony of Carlisle John Thorson.)

The Court: I think I will have to sustain that objection. It seems to me that this witness, as a corporation adviser, doubtless does have quite a good deal of information as to what different corporations pay, but I think it is so well known that the Court will take judicial notice that there is no uniformity of salary, one industry might pay a great deal more in proportion than another and it seems to me that in order to qualify this witness as an expert and to entitle him to give the Court an opinion as to whether he regarded the salary paid Mr. Kennedy and Mr. Hayek as reasonable, he would have to have knowledge of that sort of business and have a good deal of familiarity with that sort of business. I don't think this witness has. He has a general knowledge doubtless of corporation reorganization and corporate business. [148] I think I will have to sustain that objection, Mr. Orem.

Mr. Orem: I ask that an exception be noted.

The Court: Yes.

Mr. Orem: Of course it is a matter of opinion really as to whether a man with better knowledge could qualify on this.

The Court: Yes. Well, that is a question for the Court. I would not be entirely free from doubt. I think that at best expert testimony is not as valuable to the Court as the testimony as to what this man did and the volume of business and the earnings that came in. That after all is more valuable to the court than anything else. I have of

(Testimony of Carlisle John Thorson.)

course a willingness, counsel, to receive expert testimony for whatever it may be worth to the Court in weighing the facts, but I think it involves a **certain** amount of experience and knowledge of the business in order to qualify the witness to give testimony that would be of value.

Mr. Orem: I am of course submitting Mr. Thorson as a witness with financial experience and with a general knowledge of salaries.

The Court: Yes.

Mr. Orem: In the industry in general, not in this particular industry.

The Court: Yes, but I think I will have to—my best judgment would be not to admit it.

Q. (By Mr. Orem): Now, Mr. Thorson, have you had any experience in the—do you have any knowledge of the salaries paid in the plating industry? A. Not specifically, no.

Q. Or in metal fabrication?

A. Well, to some extent metal fabrication, yes, not specifically. However, I have had occasion to process a metal fabrication company.

Q. What type of metal fabrication, what types?

A. Airplane manufacture for one, furniture, metal furniture.

Mr. Orem: That is all.

The Court: I admitted the testimony of Mr. Miller because he was familiar with the industry and had knowledge of it.

Mr. Orem: In other cases I have had the testimony of bankers admitted with general knowledge,

(Testimony of Carlisle John Thorson.)

somewhat similar experience. Of course, still as you say it is just a matter——

The Court: Yes. I think with all due respect to the witness that his opinion could not help the court very much, even if it was expressed, because of his lack of knowledge of this specific business.

Q. (By Mr. Orem): You don't have any particular knowledge of the nameplate business? [150]

A. I do not.

Mr. Orem: Very well, that is all.

Mr. Tonjes: No questions.

(Witness excused.) [151]

JOSEPH W. HAYEK

called as a witness for and on behalf of the Petitioner, having been first duly sworn, was examined and testified as follows:

Direct Examination

By Mr. Orem:

Q. Please state your full name?

A. Joseph W. Hayek.

Q. What office do you hold at the present time in the Kennedy Nameplate Company?

A. President.

Q. How long have you continuously held that office?

A. Since 1923, since it was incorporated.

Q. Have you also been a director of the company since that date? 1923? A. Yes.

Q. At any time from 1923 to the present time,

(Testimony of Joseph W. Hayek.)

did you devote any portion of your time to any other business than the Kennedy Nameplate Company?

A. No. [152]

Q. Will you please state the extent of your technical education?

A. Well, I went to gymnasium school in Czechoslovakia, studied chemistry and mathematics. Then I took a course for two years at the Cal Tech here, and in 1908 I started the nameplate industry because that was something new that was brought to this country in 1906, and I was very much interested because it took so much chemical information to do it. In 1909 I took charge of the Crowe Nameplate & Engraving Plant in Chicago, just a small plant at that time.

In 1912 I started Greenduck Company nameplate department. In 1914 I took charge of the Chrysler nameplate in Chicago. In 1915 I went to Minneapolis and took charge of the Sager Manufacturing Company. In 1917 or '18 I started in business for myself, until 1921 when I sold to Mr. Kennedy and his uncle. They moved the plant to Los Angeles, and I came out here and I bought out Mr. Kennedy's uncle, and in 1923 we were incorporated.

Q. From 1907 to 1946, most of the time were you engaged in any other business except the nameplate business?

A. No.

Q. You put your entire business experience from 1907 to this date as being in the nameplate business?

A. That is right.

Q. And now prior to your association with the

(Testimony of Joseph W. Hayek.)

Kennedy [153] Nameplate Company, did you have any offers from any other companies of salaried positions in the nameplate business?

A. In January, 1930, I was in Chicago and the Crowe Nameplate & Engraving Company whom I worked for in 1909, '10 and '11, made me an offer to take charge of their nameplate department, outside of the die making department, and at a salary of \$12,000 a year plus 20 per cent of the scrap, with a contract for five years if I desired, and I could have a contract for any length of time. They offered to buy the Kennedy Nameplate out at that time.

Mr. Orem: For the record the name of the Crowe Nameplate Company is C-r-o-n-a-m-e?

The Witness: C-r-o-w-e.

Q. (By Mr. Orem): Did you have any offers from any other companies?

A. Yes, I had prior to that, a year, around that, a firm out in Middleboro, Massachusetts, Colonial Brass Company, Middleboro, Massachusetts, at a salary of \$7500 a year. That was in 1921 or '2.

Q. When you were with this Crowe Nameplate Company that you described, about how many employees did they have?

A. When I first started there we had only about six.

Q. And do you know how many employees that firm has now?

A. They have over 3,000 employees at the present time. [154]

(Testimony of Joseph W. Hayek.)

Q. As president of the Kennedy Nameplate Company during the years ending June 30, 1941, and June 30, 1942, just what were your duties? What did you do during those years?

A. My duties was complete charge of production. In the nameplate business there are at least ten very important different trades hired, and I have to watch that production from the art department and the die making and engraving and shearing, packing and everything, the whole production.

Q. Just how many different processes are there in production?

A. Well, there is the art department and photographic department, there is the lithographic department, there is the etching, there is plating, there is shearing, there is die making, punch press operations, and engraving.

Q. You are in charge of all those departments?

A. Yes, and the decalcomania department.

Q. During your employment with the Kennedy Nameplate Company, have you perfected any new processes of manufacture or techniques?

A. Many of them. Every few months we have to get something new. That is my end of the business.

Q. Will you describe what new processes or techniques you did devise?

A. Well, first I set up the repeat camera on our [155] negatives, instead of making so many prints on paper and pasting them up and photographing them, we just make a negative, and to make it I

(Testimony of Joseph W. Hayek.)

made my multiplying camera where you put the negative in there and multiply it like that.

Then in the etching and in the lithographic department where there is about thirty-two operations to completely finish the article, we eliminate powdering, painting, fixing and baking on certain jobs, and our plating we have a setoff process and on plating colors, there are three or four different ways to plate colors, and where we used to put them in with a little brush, we spray them in or lithograph the colors in. In etching we deviated from the regular routine zinc process in order to get the electrochemical process, and that didn't work out very good and a new process was proposed on that by us.

In the die making department, we make quite an improvement in making dies by saving time, instead of making a regular layout we make our layout by photographic processes.

In the engraving department we improve it by setting up type in a straight line, and we make an attachment whereby we can put the same straight line on a curve on a plate, something where the manufacturer of the engraving machine made the remark it was impossible. I spent a lot of my time extra on different chemicals to oxidize special metals, instead of using color for plating process we use oxidizing [156] solution whereby we can oxidize a hundred or a hundred and twenty pieces at one time and take maybe ten minutes whereby spraying it would take maybe four or five hours.

Our oxidizing zinc, which was impossible to do

(Testimony of Joseph W. Hayek.)

until several years ago, when I got a solution, and we are the only firm on the West Coast that does anything like that.

And then during the war I had to work out processes for plastics and fibre, fluorescent plates, we worked them out in our plant, and many others that I can't remember.

Q. How many hours per day do you work?

A. Well, I am the first one in in the morning. I put in twelve to fourteen hours a day and Saturday about six, and many times I worked there on Sunday during the war, when there was something that was very important, I worked there more than once, worked all night, just to get through because our work can't depend on a helper and too many different processes they go through, I have to watch for a certain amount of time one process one evening. By going through every department in that way having to watch everything I have to be there.

Q. During the years 1941 and 1942, just what hours did you work every week on an average?

A. I would say about 70 or 75 hours a week.

Q. How did those hours compare with those that you worked in 1940 and 1939?

A. Well, I—1939 I didn't work quite as many hours. [157]

Q. About how many hours did you work in 1939?

A. Oh, I worked about nine hours a day five days a week, eight to nine hours a day.

Q. In 1940 how many hours?

A. 1940 because we had—well, in 1940 we started

(Testimony of Joseph W. Hayek.)

to work in aircraft production for France and Russia, and at that time we had to do a lot of experimenting and a lot of work that was in a hurry, so I spent quite a bit of time there.

Q. What compensation did you receive for your service from the Kennedy Nameplate Company for the year ending June 30, 1940? A. \$17,000.

Q. For the year ending June 30, 1942?

A. The same thing.

Q. And did you also receive some proceeds from the sale of scrap in those two years?

A. Yes, I did, yes.

Q. You received the amounts that are shown in the tax returns? A. Yes, that is right.

Q. For those years, in the individual tax returns for yourself and Mrs. Hayek?

A. That is right.

Q. And what did you consider that sum that you received [158] from the sale of scrap to be, what nature?

A. Well, I didn't give it any consideration. I figured it was pin money, because everywhere I ever worked I always got the scrap or a certain part of the scrap. When I was offered the job there by Crowe Nameplate in 1930 my salary was \$12,000 a year plus 20 per cent of the scrap, and in 1916 when I was working at the Sager Manufacturing in Minneapolis, my salary was \$4420 plus the scrap of all metal except silver, sterling silver.

Q. Now, you have known Mr. Kennedy I believe since 1921? A. That is right.

(Testimony of Joseph W. Hayek.)

Q. You have been associated with him in business since that time? A. That is right.

Q. Have you had an opportunity to observe his qualifications? A. That is right.

Q. Do you know what salary he received from the company in 1941 and 1942?

A. That is right.

Q. Have you an opinion as to whether he reasonably earned that amount of money or not?

A. I should think he did. [159]

Q. You tell me you got an offer of employment from the Crowe Nameplate?

A. Crowe Nameplate & Engraving Company.

Q. When did you get that offer?

A. In January, 1930, during the depression.

Q. Do you know how big an organization that was in 1930 or at about the time they made the offer?

A. At that time they made the offer they employed about six hundred people. [160]

Q. About six hundred?

A. Yes. I was supposed to be in full charge of the nameplate department, for they wanted to get their nameplate into right production.

Q. Do you know how many people they had engaged in the nameplate department of which you were to take charge?

A. I couldn't say. About 80 or 100.

Q. You say they offered you how much money?

A. \$12,000 a year plus 20 per cent of the scrap and thereafter I could write my own contract for

(Testimony of Joseph W. Hayek.)

five years or didn't have to wait on them if there is anything I wanted.

Q. You don't know how much their sales were?

A. No, I don't.

Mr. Tonjes: That is all, I think. [161]

[Title of Tax Court and Cause.]

DESIGNATION OF CONTENTS OF RECORD ON REVIEW

To the Clerk of the Tax Court of the United States:

You will please prepare, transmit and deliver to the Clerk of the United States Court of Appeals for the Ninth Circuit copies duly certified as correct of the following documents and records in the above-entitled cause in connection with the petition for review heretofore filed by Kennedy Name Plate Company:

(1) The docket entries of all proceedings before the Tax Court.

(2) Pleadings before the Tax Court, as follows:

(a) Petition.

(b) Answer.

(3) The memorandum findings of fact and opinion of the Tax Court.

(4) Petitioner's motion to vacate and set aside the memorandum findings of fact and opinion.

(5) Order denying motion to vacate and set aside memorandum findings of fact and opinion heretofore entered.

(6) The decision of the Tax Court under Rule 50 entered July 30, 1947.

(7) The petition for review. [162]

(8) Notice of filing petition for review.

(9) From the official transcript of oral testimony the following:

(a) Index.

(b) Proceedings from Page 1 to and including line 8 on page 6.

(c) That testimony of William James Kennedy which begins on Page 15 at line 2 to and including line 20 on page 39.

(d) That testimony of William James Kennedy which begins on page 79 at line 11 to and including line 3 on page 97.

(e) That testimony of William James Kennedy which begins on page 106 at line 19 to and including line 4 on page 114.

(f) That testimony of William James Kennedy which begins on page 116 at line 16 to and including line 11 on page 119.

(g) That testimony of Charles W. Miller which begins on page 119 at line 12 and ends upon page 138 at line 19.

(h) That testimony of Carlisle John Thorson which begins on page 138 at line 20 and ends upon page 149 at line 4.

(i) That testimony of Joseph W. Hayek which begins on page 150 at line 6 to and including line 24 on page 157.

(j) That testimony of Joseph W. Hayek

which begins on page 170 at line 17 to and including line 14 on page 171.

(10) This designation of contents of record on review.

/s/ PRESTON D. OREM,
Counsel for Petitioner.

Personal service of the foregoing designation is hereby acknowledged as having been made this 13th day of November, 1947.

/s/ CHARLES OLIPHANT, CAR,
Chief Counsel, Bureau of
Internal Revenue,
Counsel for Respondent.

[Endorsed]: Filed Nov. 24, 1947. [163]

[Title of Tax Court and Cause.]

CERTIFICATE

I, Victor S. Mersch, clerk of The Tax Court of the United States, do hereby certify that the foregoing pages, 1 to 163, inclusive, contain and are a true copy of the transcript of record, papers, and proceedings on file and of record in my office as called for by the Praeceptum in the appeal (or appeals) as above numbered and entitled.

In testimony whereof, I hereunto set my hand and affix the seal of The Tax Court of the United States, at Washington, in the District of Columbia, this 28th day of November, 1947.

[Seal] /s/ VICTOR S. MERSCH. EMT
Clerk, The Tax Court of the
United States.

[Endorsed]: No. 11804. United States Circuit Court of Appeals for the Ninth Circuit. Kennedy Name Plate Company, a Corporation, Petitioner, vs. Commissioner of Internal Revenue, Respondent. Transcript of the Record. Upon Petition to Review a Decision of The Tax Court of the United States.

Filed: December 2, 1947.

/s/ PAUL P. O'BRIEN,

Clerk of the United States Circuit Court of Appeals
for the Ninth Circuit.

In the United States Circuit Court of Appeals
for the Ninth Circuit

Docket No. 11804

KENNEDY NAME PLATE COMPANY,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

STATEMENT OF POINTS FOR PETITIONER
AND DESIGNATION FOR PRINTING
UNDER SUBDIVISION 6 OF RULE 19

Points on Appeal

(1) The Tax Court of the United States erred in failing to allow as a deduction under section 23 (a)(1)(A) Internal Revenue Code, as reasonable compensation for services rendered by its two officers any amount in excess of the regular salaries

paid each year in the total amount of \$24,000.00 plus proceeds from the scrap sales.

(2) The Tax Court erred in holding that the payments of the bonuses to the two officers in the total amount of \$10,000.00 for each year were in the nature of dividend distributions on stock and not deductible by petitioner as ordinary and necessary expenses under section 23 (a)(1)(A) of the Internal Revenue Code.

(3) The Tax Court erred in finding that there were deficiencies for the taxable years ended June 30, 1941, and June 30, 1942, in lieu of a determination that there were no income taxes, declared value excess-profits taxes and excess profits taxes due from the petitioner for the two years in controversy.

(4) The Tax Court erred in declining to grant petitioner's motion to vacate and set aside the memorandum, findings of fact, and opinion on the grounds that the Tax Court had not complied with the provisions of the Administrative Procedure Act. (Chapter 324—Public Law 404.)

(5) There was no substantial evidence to justify the findings of the Tax Court within the provisions of the Administrative Procedure Act, and more particularly Section 10(e) of said Act.

(6) The Tax Court erred in not giving full faith and credit to the resolution of the Board of Directors of petitioner, adopted at the regular meeting of said Board on June 11, 1941, voting bonuses of \$5,000 each to the two officers of petitioner.

(7) The Tax Court erred in declining to give proper weight to the testimony of Charles N. Miller with respect to the reasonableness of the compensation paid by petitioner to its two principal officers.

Designation for Printing

Petitioner designates for printing the entire certified transcript as prepared by the Tax Court of the United States.

/s/ PRESTON D. OREM,
Counsel for Petitioner.

Personal service of the foregoing Statement of Points for Petitioner and Designation for Printing under Subdivision 6 of Rule 19, is hereby acknowledged as having been made this 10th day of December, 1947.

/s/ THERON L. CANDLE,
Assistant Attorney General,
Counsel for Respondent.

[Endorsed]: Filed Dec. 16, 1947.

